Supreme Court, U.S.
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No. 07-

IN THE

Supreme Court of the United States

DIRECTV, INC. and ECHOSTAR SATELLITE L.L.C.,

Petitioners,

– v. –

MARK TREESH, Commissioner for the Department of Revenue for the Commonwealth of Kentucky,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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January 31, 2008

QUESTION PRESENTED

Consumers typically subscribe to television service through either of two means—cable or satellite. Cable companies hire legions of workers locally to lay cables and pay local governments significant franchise fees for valuable rights of way. Satellite providers build their significant infrastructure outside the boundaries of any particular state—in outer space. Kentucky has crafted a clever tax-and-subsidy scheme that favors the service that is intensely local while burdening the service whose infrastructure lies predominately out of state. Kentucky taxes both services, but uses the proceeds to defray a cost on behalf of cable companies, alone.

Does the practical effect of this tax-and-subsidy scheme discriminate against interstate commerce in violation of the Dormant Commerce Clause?

PARTIES TO THE PROCEEDING BELOW AND RULE 29.6 STATEMENT

The caption on this petition lists all parties to the proceeding before the Court of Appeals.

Petitioner DIRECTV, Inc. (DIRECTV) is an indirect wholly owned subsidiary of The DIRECTV Group, Inc., a publicly owned Delaware corporation. The DIRECTV Group, Inc. is approximately 41% owned by Fox Entertainment Group, a publicly owned Delaware corporation, which is wholly owned by News Corporation, also a publicly owned Delaware corporation.

Petitioner EchoStar Satellite L.L.C. (EchoStar) is an indirect wholly owned subsidiary of DISH Network Corp. (formerly known as EchoStar Communications Corp. and hereinafter "DISH"), a publicly owned Nevada corporation. DISH is controlled by Mr. Charles W. Ergen, an individual. Barclays plc, a company publicly traded on the London Stock Exchange, holds an indirect interest of approximately 10.5% in DISH through various subsidiaries. In addition, certain publicly traded mutual funds managed by Fairholme Capital Management, LLC, collectively hold an interest in DISH of approximately 10.5%.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit, dated May 31, 2007, is reported at *DIRECTV, Inc. v. Treesh*, 487 F.3d 471 (6th Cir. 2007), and is reproduced in the Appendix to this Petition (App.) at 1a-20a. The order of the Court of Appeals denying Petitioners' petition for rehearing en banc is unpublished, and is reproduced at App. 56a. The opinion of the U.S. District Court for the Eastern District of Kentucky, dated March 30, 2006, is reported at *DIRECTV, Inc. v. Treesh*, 469 F. Supp. 2d 425 (E.D. Ky. 2006), and is reproduced at App. 21a-55a.

JURISDICTION

The Court of Appeals entered an opinion on May 31, 2007, upholding the District Court's dismissal of Petitioners' complaint. A timely petition for rehearing en banc was denied on September 18, 2007. On November 29, 2007, Justice Stevens granted Petitioners an extension until January 31, 2008, to file this petition. This Court has jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

The Commerce Clause provides: "The Congress shall have the Power ... [t]o regulate Commerce ... among the several States." U.S. Const. art. I., § 8, cl. 3. This case involves Kentucky Revised Statutes (KRS) §§ 136.602, 136.604, 136.616, 136.648, 136.650, 136.652, and 136.660, which are reproduced in relevant part, beginning at App. 57a.

INTRODUCTION

If Court of Appeals opinions came with headlines, this one would read like an obituary:

> "*West Lynn Creamery* Dead; Dormant Commerce Clause Gutted."

The Dormant Commerce Clause prohibits states from adopting taxing schemes that disproportionately burden out-of-state economic interests to give in-state economic interests a competitive edge. In *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), this Court held that states may not achieve the same discriminatory result by sleight of hand: States may not, for example, adopt schemes that purport to collect taxes evenhandedly from in-state and out-of-state economic interests, but then turn around and use the very same funds to subsidize only the in-state interests.

The Court of Appeals has handed every state a roadmap by which to accomplish the same result: Instead of discriminatorily subsidizing the in-state interests by paying them cash, all the state must do is discriminatorily pay an expense on their behalf. The discriminatory effects are the same, and the evils are just as pronounced, but the Court of Appeals has held that this trivial adjustment insulates a discriminatory scheme from constitutional attack. This Court has never addressed whether its holding can be evaded so easily. But if this view of the law is correct, *West Lynn Creamery* is a dead letter, and states will clamor to apply this newfound license to indulge their most protectionist inclinations.

At the same time, the Court of Appeals has

gutted an even larger swath of Dormant Commerce Clause jurisprudence. It has held that a discriminatory law, no matter how blatantly protectionist in motive and effect, will survive Dormant Commerce Clause scrutiny so long as a court can imagine some additional benign motive for enacting the law—a holding that conflicts with decades of jurisprudence.

Depending on one's perspective, the obituary might be an occasion to mourn or to rejoice. But either way, if that is to be the result, the decision should come from this Court. The lower courts need this Court's guidance both to clear up confusion about how to apply Dormant Commerce Clause principles to subsidy schemes and to address other errors that undermine the Dormant Commerce Clause protections this Court has consistently articulated.

STATEMENT

Cable and Satellite Providers Engage in Different Levels of Local Activity and Investment

Consumers who wish to subscribe to a wide menu of television programs have two main choices: cable or satellite. From the consumer's perspective, both offer essentially the same service, referred to in the industry as "multichannel television programming service." But because the signals are delivered through different means, the two types of providers build different infrastructures. And those different infrastructures entail vastly different levels of local activity and local investment.

The infrastructure for cable service is intensely

local. To reach their subscribers, cable companies hire legions of workers within each state and invest heavily in building and servicing intricate webs of wires, underground and on utility poles. App. 3a. Businesses do not get to dig up roads and hang wires off utility poles for free. Cable companies pay local governments rent in the form of franchise fees, both for the valuable property rights and for the cost and disruption incident to installing and servicing their networks. App. 4a. Typically, the local government charges a franchise fee that is 5% of the gross revenue the cable company derives from subscribers within the locale. App. 23a; 47 U.S.C. § 542(b) (capping franchise fees at 5%). This fee, which is fairly ubiquitous, represents a significant cost of doing business—like rent, labor, and raw materials—which cable companies pass on to consumers. *See* Compl. ¶ 10.

In contrast, the infrastructure for distribution of satellite service is almost entirely outside any particular state—in outer space. App. 22a. Satellites are expensive to build, launch, and maintain. Over the past decade, satellite providers have invested over $1 billion in building their celestial infrastructure. App. 3a. But, for the most part, their investment does not flow locally. Satellite service does not require armies of local workers. *Id.* Nor can local governments extract franchise fees for rights of way, because satellite companies do not need to dig trenches or hang wires on public property. *Id.* Indeed, in part for that reason, Congress has made it illegal for local governments to charge satellite providers franchise fees. *See* Telecommunications Act of 1996, Pub. L. No. 104-104, § 602(a), 110 Stat. 56, 144 (1996) (codified at 47 U.S.C. § 152 note).

Consumers are largely agnostic about these differences in infrastructure. They do not care much whether their television signal travels through local cables or through airwaves from outer space. They care about what programs they can get and they care about price—a lot. *See* Andrew Stewart Wise & Kiran Duwadi, *Competition Between Cable Television and Direct Broadcast Satellite: The Importance of Switching Costs and Regional Sports Networks*, 1 J. Competition L. & Econ. 679, 702-03 (2005). Consequently, when satellite providers entered the picture, they introduced an element of price competition that had been missing for two decades, *id.* at 703, which is why Congress and the Federal Communications Commission (FCC) have both been intent on promoting satellite as a viable competitor to cable, *see infra* at 19-22.

States Promote Cable over Satellite with Discriminatory Taxes

States and local governments have been neither as agnostic to the mode of delivery as consumers, nor as receptive to the competition as federal authorities. The reason is simple: Cable's success translates directly into increased revenues for cash-starved local governments, more local jobs, and enhanced investment in local infrastructure. As the cable industry reports, it funnels $2.8 billion annually in franchise fees to local governments and employs 1.1 million "local workers." *See* Nat'l Cable & Telecomm. Ass'n, *2007 Industry Overview*, at 7 (2007), *available at* http://i.ncta.com/ncta_com/PDFs/NCTA_Annual_Report_04.24.07.pdf; Compl. ¶¶ 20-21. When satellite wins in the marketplace with a signal

beamed from space, the benefits to states and local governments diminish proportionately. From the perspective of states and local governments, it might as well be a battle between a cash cow and an alien invader with a taste for beef.

In the interest of reaping the local benefits, several states have devised a variety of mechanisms to advantage cable over satellite. Among their favorite tools have been discriminatory taxes. Some have been blatant. Ohio, for example, enacted an overtly discriminatory law that taxed only satellite and not cable. *See* Ohio Rev. Code § 5739.01(B)(3)(p). The tax reeked of local protectionism. As an Ohio court observed, an impetus for the statute was the argument that "the cable television industry employs many more people in Ohio, and ... has invested much more heavily in Ohio, than the ... satellite industry." *DIRECTV, Inc. v. Wilkins*, No. 03CVH06-7135, slip op. at 2 (Ohio Ct. C.P. Oct. 17, 2007) (unpublished). The court promptly struck the law as an impermissible discrimination against interstate commerce. The court noted that "the statute's different effects on the Satellite Companies and Cable Companies has everything to do with the geographic location of one of their economic activities." *Id.* at 53-54.

Other states have displayed the same parochial favoritism toward cable interests as Ohio, but devised craftier schemes. They reached the same discriminatory end by taking with one hand from both satellite and cable, and giving back with the other—whether in the form of a subsidy or a tax credit—but only to cable. *See, e.g.*, Fla. Stat. § 202.12(1)(a)-(b); N.C. Gen. Stat. § 66-351(a);

Tenn. Code Ann. § 67-6-714; Utah Code Ann. § 59-26-104.5; Va. Code Ann. § 58.1-662(A)-(C).[1]

Kentucky Imposes a Discriminatory Tax-and-Subsidy Scheme

This case is about one such circuitous route toward local protectionism, a law Kentucky passed in 2005. *See* 2005 Ky. Acts ch. 168, §§ 88-118 (codified at KRS §§ 136.600 to .660). Under the status quo before Kentucky enacted the legislation at issue here, the state imposed no tax on subscriptions to either satellite or cable. To be sure, local governments in Kentucky, as in virtually all other states, collected *franchise fees* from cable companies in return for cable's access to valuable local rights of way. But these franchise fees are as different from sales taxes as rent on a government-owned concession stand is from income taxes. App. 25a.

From this status quo, Kentucky accomplished its discriminatory subterfuge in two steps—a tax and a discriminatory subsidy—both enacted as part of the same legislation. Step one is a seemingly evenhanded tax. Kentucky imposed an excise and a gross-receipts tax totaling 5.4%, on all "multichannel video programming service"—

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[1] Petitioners have challenged most of these laws, as well. *See DIRECTV, Inc. v. Tolson*, __ F.3d __, 2008 U.S. App. LEXIS 450 (4th Cir. Jan. 10, 2008) (affirming dismissal of complaint on comity grounds); *DIRECTV v. Chumley*, No. 03-2408-IV (Tenn. Chan. Ct., Davidson County filed Aug. 19, 2003); *DIRECTV, Inc. v. Dep't of Revenue*, No. 372005CA-001037A00100 (Fla. Cir. Ct., Leon County filed May 4, 2005).

defined as "cable service and satellite broadcast and wireless cable service." KRS § 136.602(8); App. 5a. The excise tax—essentially a sales tax tacked onto each consumer's monthly bill—is 3% of the subscription price. KRS § 136.604(1)-(2). The gross-receipts tax is set at 2.4% of revenues derived from subscribers within the state. *Id.* § 136.616(2)(a). The revenues from both taxes are segregated into a special fund. *Id.* § 136.648(3).

Step two is the discriminatory subsidy: Kentucky allocates almost the entire segregated fund—collected from both cable and satellite providers—exclusively to the benefit of cable companies. The statute directs that virtually all of the funds be spent to pay cable's local franchise fees. *Id.* § 136.652 (distributing the special fund to local governments, except for a small fraction). The statute achieves this result through a transparent shell game: The law purports to prohibit local governments from levying franchise fees directly. *Id.* § 136.660(1). But it directs that the proceeds of the segregated fund flow directly to the local governments that would otherwise be entitled to the franchise fees—in proportion to the franchise fees they had historically been collecting. *Id.* §§ 136.648(3), 136.650(1)-(2), 136.652(2). In other words, local governments still pocket the franchise fee revenues they had always collected, but the state acts as their collection agent.

As if to shine a spotlight on the sleight of hand, the statute allows for the possibility that some local governments will continue to collect franchise fees directly from cable companies, *see id.* § 136.660(4), and directs that when that occurs, the cable companies will enjoy a full credit against their state

taxes, and the local government will not receive its allocation of the state taxes, *id.* § 136.660(5).

The net result is parochial favoritism with a faint patina of equality. Sure, cable and satellite providers now pay the same state tax. But the state uses the proceeds from the tax to subsidize cable—by paying a bill, on cable's behalf, that cable alone would otherwise pay for its purely in-state activities. Satellite providers, whose infrastructure and investment are entirely out of state, get no costs defrayed, because they are not subject to franchise fees. In short, Kentucky has now forced the customers of satellite providers to pay a tax that they never had to pay, and it uses this tax to subsidize a cost for cable alone. With this clever device, it drives down cable's costs, giving it a 5% price advantage over its satellite competitors.

Satellite Providers Challenge the Law

Petitioners DIRECTV and EchoStar are the two largest providers of satellite programming in the nation. They filed an action in federal court in Kentucky alleging that the Kentucky scheme violates the Dormant Commerce Clause.

The District Court dismissed the complaint, concluding that Petitioners could not establish a Dormant Commerce Clause violation. App. 21a.

The Court of Appeals affirmed the dismissal. It accepted all the facts alleged in the complaint as true. Thus, for purposes of this appeal, the following must be taken as fact: First, "the satellite companies ... employ inherently out-of-state facilities and have very little in-state infrastructure, while ... the cable companies ... employ necessarily expansive in-state facilities to

deliver their television service." App. 8a; *see* Compl. ¶¶ 16-17, 19-21. Second, under the Kentucky tax, "cable companies receive a tax preference because revenues from the state excise and gross revenues tax are used to pay the franchise fees that cable operators would otherwise have to pay local governments for access to local rights-of-way." App. 7a; *see* Compl. ¶¶ 25-30. Third, "[t]he satellite companies pay the new taxes, but [unlike cable] receive no relief from their operating costs." App. 8a; *see* Compl. ¶ 30.

Nevertheless, the Court of Appeals concluded that these facts could not, under any circumstance, make out a Dormant Commerce Clause violation. The Court of Appeals reasoned that the Kentucky tax differed from the unconstitutional tax-and-subsidy scheme of *West Lynn Creamery* in three ways: (1) the subsidy is not a "direct monetary subsidy," but is rather "only the right to conduct business and use local rights-of-way without local taxation or fees"; (2) satellite and cable are "distinct" products, "consisting of two very different means of delivering broadcasts," so there is no discrimination; and (3) in addition to its desire to favor cable for its in-state activities, the Kentucky Legislature might "possibly" have also been motivated by more benign goals. App. 19a.

The Court of Appeals denied a petition for rehearing en banc. App. 56a.

REASONS FOR GRANTING THE WRIT

I. KENTUCKY'S TAX-AND-SUBSIDY SCHEME RAISES A NOVEL DORMANT COMMERCE CLAUSE ISSUE.

The premise of this Court's Dormant Commerce Clause jurisprudence is that when the Constitution grants Congress jurisdiction over interstate commerce, it implicitly prohibits "economic protectionism" by and among the various states, as well. *New Energy Co. v. Limbach*, 486 U.S. 269, 273-74 (1988). The "paradigmatic example" of an impermissible barrier to trade is the protective tariff—when a state imposes a higher tax on goods or services that came from out of state than on the same goods or services from within the state. *West Lynn Creamery*, 512 U.S. at 193. But in this area, substance matters more than the "form by which a State erects barriers to commerce." *Id.* at 201. Accordingly, this Court has struck other tax devices—however "ingenious"—that yield the same protectionist effect. *Id.* (internal quotation marks omitted).

Confusion persists, however, as to which tax devices, and combinations of devices, are impermissibly discriminatory and which are not, for this Court has "never held that *every* state law which obstructs a national market violates the Commerce Clause." *Id.* at 207 (Scalia, J., concurring) (emphasis added). The uncertainty is especially pronounced when seemingly evenhanded taxes—taxes that apply equally to in-state and to out-of-state activities—are coupled with *subsidies* that redound exclusively to the benefit of in-state interests. On the one hand, this Court has held

that states may "structur[e] their tax systems to encourage the growth and development of intrastate commerce and industry," *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977), and as a general matter, they can promote in-state industry with cash subsidies, *see New Energy*, 486 U.S. at 278; *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 809-10 (1976); *West Lynn Creamery*, 512 U.S. at 199 n.15; *id.* at 211 (Scalia, J., concurring). On the other hand, the last time this Court encountered a tax-and-subsidy scheme—14 years ago, in *West Lynn Creamery*—it struck a seemingly even-handed tax the proceeds of which were directed to subsidize only intrastate commerce.

In *West Lynn Creamery*, Massachusetts taxed milk wholesalers on their purchases of milk from both in-state and out-of-state producers. 512 U.S. at 190. This non-discriminatory tax had a discriminatory effect, however, because it was tethered to a cash subsidy: The tax went into a segregated fund, the proceeds of which subsidized only in-state milk producers. *Id.* at 190-91.

In ruling that this tax-and-subsidy scheme was impermissibly discriminatory, this Court did not articulate a clear line between a permissible subsidy to spur local growth and discriminatory protectionism. Even though it acknowledged that "'[d]irect subsidization of domestic industry does not *ordinarily* run afoul' of the negative Commerce Clause," *id.* at 199 n.15 (quoting *New Energy*, 486 U.S. at 278) (emphasis added), the majority opinion appeared to sweep broadly. It disapproved of a tax-and-spending scheme that "artificially encourag[es] in-state production even when the

same goods could be produced at lower cost in other States," or that "neutraliz[es] the advantage possessed by lower cost out-of-state producers." *Id.* at 193-94.

A bare majority of five Justices subscribed to the Court's rationale in *West Lynn Creamery*. In a concurrence, Justices Scalia and Thomas expressed discomfort with the breadth of the Court's reasoning on subsidies. They cautioned that "[t]he object should be ... to produce a clear rule that honors the holdings of our past decisions but declines to extend the rationale that produced those decisions any further." *Id.* at 210 (Scalia, J., concurring).

Both the breadth of the Court's opinion in *West Lynn Creamery* and the cautionary note about extending the doctrine have left lower courts with little guidance about how to assess other taxing schemes that are linked to subsidies. In the wake of *West Lynn Creamery*, prominent commentators bemoaned the uncertainty on "important questions about" when courts "should treat subsidies as freestanding exercises of the state's spending power, on the one hand, or as tax credits or exemptions, on the other," that can make an otherwise evenhanded tax impermissibly discriminatory. Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures*, 95 Mich. L. Rev. 2167, 2175 (1997).

They have variously noted that *West Lynn Creamery* "leaves serious doubts about the Court's view of tax-financed subsidy programs," Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax*

Incentives for Business, 110 Harv. L. Rev. 377, 443 (1996); urged the Court to "clarify its Commerce Clause jurisprudence," *id.* at 457; called for "a better justification for the formal line or an analysis that justifies the differing treatment of tariffs and subsidies on some basis other than a strictly formal one," Christopher R. Drahozal, *On Tariffs v. Subsidies in Interstate Trade: A Legal and Economic Analysis*, 74 Wash. U. L.Q. 1127, 1142 (1996); and lamented that "the difficult task of answering these questions must for now proceed unguided by any well-developed jurisprudential theory offered by the Supreme Court." Coenen & Hellerstein, *supra*, 95 Mich. L. Rev. at 2175; *see also* Dan T. Coenen, *Business Subsidies and the Dormant Commerce Clause*, 107 Yale L.J. 965, 1003 (1998) (noting that "each of the three opinions"—including the dissent—in *West Lynn Creamery* "seeks to cast light" on the reasons why subsidies should be treated differently than discriminatory taxes, but that "none of these efforts meets with much success").

This Court recently took a case that could have clarified the principles and standards in these sorts of cases, but did not reach the merits for jurisdictional reasons. *See DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2006). This case presents an opportunity free of jurisdictional obstacles.

In the absence of a "well-developed jurisprudential theory," the lower courts have adopted inconsistent approaches to taxes and subsidies—particularly when it comes to applying this Court's admonition that the Dormant Commerce Clause is not "so rigid as to be controlled by the form by which a State erects

barriers to commerce." *West Lynn Creamery*, 512 U.S. at 201. That directive has proven too general to be followed with consistency.

On the one extreme are courts that completely ignore form—courts that say (or behave as if) the "form by which a state erects barriers to commerce *has no effect* on the determination of whether discrimination exists." *Gen. Motors Corp. v. Dir. of Revenue*, 981 S.W.2d 561, 567 (Mo. 1998) (emphasis added) (striking limitation on right to file consolidated tax returns to affiliated companies that earn half of their income from in-state activities).

Others strive to comply with the substance-over-form directive by peering behind the form of the tax or the subsidy in search of guiding principles. They focus, for example, on such questions as whether the state has exercised its power to tax or subsidize in a manner that distorts market behavior, by favoring expenditures on in-state activities. *See Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738, 745 (6th Cir. 2004) (Ohio investment tax credit violates Commerce Clause because it can "encourage further investment in-state at the expense of development in other states"), *rev'd on other grounds*, 547 U.S. 332 (2006). Some find such a distortion in the market, even where the purported subsidy is highly indirect—just because the incentive made the out-of-state good a "less viable" option. *Alliance for Clean Coal v. Miller*, 44 F.3d 591, 597 (7th Cir. 1995).

On the other extreme are courts that seem to discount the "no-form-over-substance" directive, in an attempt not to risk extending existing

precedent. These courts treat the facts of *West Lynn Creamery* as a measuring rod, asking whether or not the scheme before them resembles the Massachusetts scheme this Court disapproved, with little regard for the underlying rationale. That is what the Sixth Circuit did in this case when it distinguished *West Lynn Creamery* on the ground that here, unlike there, "the claimed subsidy is not a direct monetary subsidy," App. 16a, without any analysis as to why it would matter whether the form of the subsidy is a cash payment or the payment of an obligation on behalf of the favored in-state industry.

This seems to be the dominant approach of courts that have addressed whether subsidies in the form of cash payments are treated differently from subsidies in the form of cost abatement. The First Circuit took the same approach in a case involving Puerto Rico's tax-and-subsidy scheme for the tire industry. *See Used Tire Int'l, Inc. v. Diaz-Saldana*, 155 F.3d 1 (1st Cir. 1998). The legislation taxed the importation of all tires and placed the proceeds into a fund used to cover the cost of recycling, processing, and exporting tires that are no longer usable. The proceeds, therefore, reduced costs that only the *local* dealers would face when disposing of used-up tires. The First Circuit rejected an analogy to *West Lynn Creamery* with the simple statement that Puerto Rico "does not subsidize local dealers at the expense of those engaged in interstate commerce." *Id.* at 5; *see also Diehl, Inc. v. Ohio Dep't of Agric.*, 806 N.E.2d 533, 536 (Ohio 2004) (upholding a fee on all milk purchases—from out-of-state and in-state milk producers, alike—even though the fee funded the costs of inspections for only in-state farms,

distinguishing *West Lynn Creamery* solely on the ground that "the Ohio fees are not a subsidy paid directly to the farmers but are instead collected to fund" the inspecting agency).

The Minnesota Supreme Court, too, placed significance in this distinction in upholding a municipality's tax-and-subsidy scheme on the waste industry. *See Zenith/Kremer Waste Sys. v. W. Lake Superior Sanitary Dist.*, 572 N.W.2d 300 (Minn. 1997). The municipality imposed a waste-management fee on all local waste, but used a portion of the proceeds to lower "tipping fees"—the fees that private waste haulers pay for the privilege of dumping waste at its local processing facility. The tax thus covered a portion of the costs associated with processing waste in the state, and burdened out-of-state processors by forcing them to pay some of those costs and compete at a price disadvantage. The Minnesota Supreme Court distinguished *West Lynn Creamery* because "[t]he use of the waste generation taxes to ... benefit[] users of the [processing] facility indirectly through lowered tipping fees, is a far cry from the direct cash subsidy found in *West Lynn*." *Id.* at 305.

Courts have not uniformly subscribed to this distinction between two types of subsidies. Both the trial and intermediate appellate courts in Minnesota reached the opposite conclusion. *See Zenith/Kremer Waste Sys. v. W. Lake Superior Sanitary Dist.*, 558 N.W.2d 288, 290-91 (Minn. Ct. App. 1997) (agreeing with trial court). Unlike the other courts, these courts looked behind the form of the subsidy, and focused on its effect. They recognized that "[h]aulers to out-of-state landfills pay the entire management fee, but do not receive

the 'rebate' that haulers to the [in-state] [f]acility receive through the ... reduced tipping fee." *Id.* at 291. "In effect, then," the "waste management fee" becomes a "tax [that] is imposed only on haulers to out-of-state landfills, and the ability of these haulers to lower their prices to compete with [the in-state facility] is impaired accordingly." *Id.*

This case presents this Court with an opportunity to provide much-needed guidance about exactly what makes a tax-and-subsidy scheme impermissibly discriminatory. In particular, this Court should resolve the open question whether a tax-and-subsidy scheme is beyond the reach of the Dormant Commerce Clause if the subsidy comes in the form of paying a cost on behalf of the local interests, rather than just putting cash in their pockets.

II. THIS CASE RAISES ISSUES OF NATIONAL IMPORTANCE.

It is important for this Court to intervene now for two reasons. First, the Court of Appeals' rationale is a roadmap for an end-run around the Dormant Commerce Clause's prohibition against discriminatory taxes and other forms of state economic protectionism. This Court has held that in order to preserve our unitary national economy, courts must treat a state tax as impermissibly discriminatory if the proceeds of the tax are directed toward paying a subsidy only for in-state activities. This rule will be a dead letter if a state can easily accomplish the same result by taking the money and returning it to the favored in-state taxpayer by a route other than a direct cash payment. If that is to be the law, it should be because this Court has so decreed, and not because

the lower courts are confused about the guiding principles.

Second, the Commerce Clause's goal—to protect barrier-free nationwide competition—is especially important in the market for television services. The sheer magnitude of the subscriber base—nearly 100 million American households—would be proof enough of a federal interest. *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 21 F.C.C.R. 2503, app. B, tbl.B1 (2006) ["FCC 2006 Annual Assessment"]. But the federal interest is all the more evident from the efforts Congress and the FCC have devoted to promoting satellite as a viable competitor to cable over the past several years.

For some 20 years, beginning in the late 1970s, any consumer who wanted to subscribe to a broad menu of television programming was stuck with one option—a local cable monopoly. *See* U.S. Gov't Accountability Office, No. GAO-05-257, *Direct Broadcast Satellite Subscribership Has Grown Rapidly, but Varies Across Different Types of Markets* 5 (Apr. 2005) ["GAO Report"], *available at* http://www.gao.gov. To the great dismay of consumers, cable took full advantage of its monopoly power, subjecting customers to ever-increasing price hikes bearing no relation to cable's costs. As Congress complained in 1992, the "average monthly cable rate ha[d] increased almost 3 times as much as the Consumer Price Index." Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, § 2(a)(1), 106 Stat. 1460, 1460 (1992) (codified at 47 U.S.C. § 521 note).

Congress felt compelled to react that year to the popular outcry over cable prices—overriding a presidential veto with overwhelming bipartisan support. Congress minced no words about the source of the problem: "Without the presence of another multi-channel video programming distributor, a cable system faces no local competition." *Id.* § 2(a)(2). "The result is undue market power for the cable operator as compared to that of consumers and video programmers." *Id.* Accordingly, Congress declared a priority to "increas[e] competition and diversity in the multichannel video programming market," and specifically to "increase the availability of ... satellite broadcast programming to persons in rural and other areas not currently able to receive such programming." *Id.* § 19, sec. 628(a), 106 Stat. at 1494 (codified at 47 U.S.C. § 548(a)). It did so by adopting measures to diminish the advantages cable enjoyed and to enhance the competitiveness of satellite broadcasters.[2]

Since then, Congress has thrice acted to overcome some of cable's artificial competitive advantages over satellite. In 1996, Congress prohibited local governments from putting their fingers on the scales of competition in specific ways. As noted above, Congress prohibited local governments from charging satellite providers

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[2] *See id.* sec. 628(b) (codified at 47 U.S.C. § 548(b)) (prohibiting cable from unfairly hindering other providers from transmitting certain kinds of programming); *id.* sec. 628(c) (codified at 47 U.S.C. § 548(c)) (prohibiting discrimination by cable-affiliated programmers against other providers).

franchise fees, *see* Pub. L. No. 104-104, § 602(a), 110 Stat. at 144, since satellite signals do not depend on the same intensely local infrastructure and rights of way as cable. Similarly, it directed the FCC to take further steps to prohibit local governments from restricting the installation of satellite dishes. *See id.* § 207(a), 110 Stat. at 114 (codified at 47 U.S.C. § 303 note). Congress also intervened in both 1999 and 2004 by leveling other advantages that cable enjoyed over satellite.[3]

The FCC, for its part, has also intervened time and again to enhance satellite's ability to compete fairly and fiercely with cable—sometimes anticipating Congress's interventions, sometimes embellishing upon them.[4] Indeed, a decade before Congress acted on the same issue, *see* Pub. L. No.

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[3] *See* Satellite Home Viewer Improvement Act of 1999, Pub. L. No. 106-113, div. B, app. I, § 1002, 113 Stat. 1501, 1501A-523 (codified at 17 U.S.C. § 122) (providing satellite the right to retransmit local network stations, like cable); Satellite Home Viewer Extension and Reauthorization Act of 2004, Pub. L. No. 108-447, div. J, tit. IX, §§ 102, 202, 118 Stat. 2809, 3393, 3409 (codified at 17 U.S.C. § 119(a) and 47 U.S.C. § 340, respectively) (same for retransmission of "significantly viewed" stations); H.R. Rep. No. 108-634, at 2 (2004) (identifying a purpose of the 2004 Act as to "increas[e] regulatory parity by extending to satellite operators the same type of authority cable operators already have").

[4] *See, e.g.*, *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 17 F.C.C.R. 12,124, ¶ 65 (2002) (prohibiting exclusive contracts between cable operators and cable-affiliated programming vendors); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 22 F.C.C.R. 17,791, ¶ 12 (2007) (same, five years later).

104-104, § 207, 110 Stat. at 114, the FCC itself took action to preempt state and local regulation of satellite dishes by holding that "[w]e will not permit a state to arbitrarily favor one particular communications service over another." *Preemption of Local Zoning or Other Regulations of Receive-Only Satellite Earth Stations*, 59 R.R.2d 1073, 1079 (F.C.C. 1986).[5]

These legislative and regulatory measures have slowly started to yield the desired results. Only in the past few years has satellite emerged as a viable rival to cable, *see* GAO Report, *supra*, at 5, expanding to 30% of the market, *see* FCC 2006 Annual Assessment, *supra*, ¶¶ 8-9; *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 17 F.C.C.R. 26,901, ¶ 58 (2002) (satellite broadcasting "has become the largest competitor to cable"). And with the proliferation of competition, predictably, has come price competition—to the benefit of the nearly 100 million households that subscribe to multichannel pay television services. *See* Wise & Duwadi, *supra*, 1 J. Competition L. & Econ. at 703.

These recent gains, however, are as incomplete as they are fragile. For one thing, cable prices have continued to rise above the rate of inflation,

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[5] *See also Preemption of Local Zoning Regulation of Satellite Earth Stations*, 11 F.C.C.R. 5809, ¶ 23 (1996) (preemption rule "assure[s] access to satellite signals and ... promote[s] competition between communications services"); *Preemption of Local Zoning Regulation of Satellite Earth Stations*, 11 F.C.C.R. 19,276, ¶ 6 (1996) ("The rule is designed to ... foster full and fair competition among different types of video programming services.").

culminating in yet another round of price hikes that the Chairman of the FCC condemned as recently as a few weeks ago. *See* Remarks of FCC Chairman Kevin Martin, *Rainbow Push Coalition, 11th Annual Wall Street Project Economic Summit* 1-2 (Jan. 9, 2008) ("The average cost of the expanded cable package (the standard cable package) almost doubled from 1995 to 2005—increasing 93%—while the cost of other communication services didn't just increase less, they *fell.*"), *available at* http://www.fcc.gov.

Why? Because, like any monopolist, cable has fought mightily to cling to any competitive edge. One of cable's most powerful competitive weapons is its political advantage in the states, where its legions of local employees and billions in local investment translate into clout in state legislatures—more clout than any enterprise that beams its signal in from outer space could hope to have. Cable has already deployed that political clout to pass discriminatory tax laws not just in Kentucky but in Florida, North Carolina, Ohio, Tennessee, Utah, and Virginia. *See supra* at 6-7. And it has recruited sponsors to introduce discriminatory tax bills in Iowa, Michigan, and New Jersey as well. S. File 390, 82nd Gen. Assem., Reg. Sess. (Iowa 2007); H.B. 4581, 94th Reg. Sess. (Mich. 2007); Assem. No. 3415, 212th Leg. (N.J. 2006). Emboldened by the Court of Appeals' opinion in this case, cable will undoubtedly pepper legislatures across the country with bills like these.

Cable is pressing these bills precisely because it understands that such tax discrimination at the state level can forestall further progress in reining in cable behavior, and indeed roll back the gains

Congress and the FCC have fostered. In competition this intense, every penny counts. In choosing between cable and satellite, rational consumers do not compare just the advertised base price. They compare the all-in price—how big a monthly check they have to write to get television service. *See* Jerry Brito & Jerry Ellig, *Video Killed the Franchise Star: The Consumer Cost of Cable Franchising and Proposed Policy Alternatives*, 5 J. Telecomm. & High Tech. L. 199, 218-19 (2006). Thus, the market is sensitive to taxes that directly increase the consumer's bill. *See* Wise & Duwadi, *supra*, 1 J. Competition L. & Econ. at 702-03. That is, of course, precisely why Congress prohibited local taxing jurisdictions from imposing franchise fees on satellite providers who do not need to dig ditches in the streets or hang wires on utility poles. *See* Pub. L. No. 104-104, § 602(a), 110 Stat. at 144. As cable providers well understand, giving cable a 5% price advantage over satellite in any state will cut deeply into satellite's competitive position. Proliferating this 5% price advantage across the country—or even just in a few key states—could scuttle all the gains that Congress and the FCC have worked so hard to foster.

The repercussions will extend beyond the market for television programming. Vindication of Kentucky's statute almost certainly means that states can discriminate against all manner of satellite-based services. States will be free to favor local radio stations over satellite radio providers (such as XM and Sirius), and to favor internet service that runs through cables or phone lines over satellite-based service (once the moratorium on taxing internet access expires). *See* Internet Tax Freedom Act, Pub. L. No. 105-277, § 1101(a),

112 Stat. 2681, 2681-719 (1998) (codified as amended, with expiration in 2014, at 47 U.S.C. § 151 note). All of these satellite-based technologies share the same political disadvantage that satellite television faces: less local political clout with which to battle local protectionism, because their distribution facilities are located outside the territorial confines of any state. *See infra* at 29-30.

Our nation has begun to see only a fraction of the benefits the public can derive from satellite-based technologies. The answer to the question whether states can sacrifice those benefits on the altar of local protectionism will have a profound impact on technological progress in this country for decades to come.

III. THE COURT OF APPEALS' DORMANT COMMERCE CLAUSE ANALYSIS IS DEEPLY FLAWED.

In distinguishing *West Lynn Creamery*, and concluding there could be no Dormant Commerce Clause challenge to Kentucky's tax-and-subsidy scheme, the Court of Appeals made three critical errors. First, it incorrectly resolved the primary question presented in this petition—whether subsidies must be treated differently when they come in the form of cost abatements rather than cash payments. Second, it incorrectly concluded that the discriminatory treatment of satellite is permissible because cable and satellite television are "distinct ... goods." Third, it concluded that a Dormant Commerce Clause violation can be excused so long as the state's discriminatory motive might arguably be accompanied by other non-discriminatory motives.

A. The Court of Appeals Erred in Distinguishing Between Two Sorts of Subsidies—Paying Cash and Covering Costs.

This Court has identified at least three tax devices that are impermissibly discriminatory. The first is the "paradigmatic example" mentioned above, when a state imposes a higher tax on goods or services from out-of-state than on the same goods or services from within the state. *West Lynn Creamery*, 512 U.S. at 193. The second is where the state imposes a seemingly evenhanded tax on an entire industry, but offsets the tax with a credit or an exemption for in-state businesses. Because the net effect is exactly the same as a tariff with greater burdens on out-of-state interests, these tax-and-credit schemes are impermissible as well. *See New Energy*, 486 U.S. at 274 (credit against fuel sales tax for in-state gasohol producers); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 272 (1984) (exemption from sales tax for locally produced alcoholic beverages); *see, e.g., Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 400 (1984) (credit against income tax for increasing domestic shipping activities); *Maryland v. Louisiana*, 451 U.S. 725, 731-33 (1981) (exemptions and credits against first-use tax on natural gas for in-state use).

The third device—the scheme this Court disapproved in *West Lynn Creamery*—is where the state imposes "a nondiscriminatory tax upon the industry, the revenues from which are placed into a segregated fund, which fund is disbursed as 'rebates' or 'subsidies' to in-state members of the industry." 512 U.S. at 210 (Scalia, J., concurring).

As Justice Scalia observed, "[t]he only difference between [a] discriminatory 'exemption' from nondiscriminatory tax ... and [a] discriminatory refund of nondiscriminatory tax ... is that the money is taken and returned rather than simply left with the favored in-state taxpayer in the first place." *Id.* at 211 (Scalia, J., concurring). As this Court held, and the concurrence agreed, that distinction makes no practical difference. *Id.* at 197. Because this Court has "declined to attach any constitutional significance to such formal distinctions that lack economic substance," *Westinghouse Elec.*, 466 U.S. at 405, the sort of tax-and-subsidy scheme at issue in *West Lynn Creamery* is treated the same as the tax-and-credit schemes this Court had already disapproved. *See West Lynn Creamery*, 512 U.S. at 201.

The same point applies with equal force to the sort of tax-and-subsidy scheme at issue here. Kentucky's scheme, like the one this Court disapproved in *West Lynn Creamery*, is also "a nondiscriminatory tax upon the industry, the revenues from which are placed into a segregated fund, which fund is disbursed as ... 'subsidies' to in-state members of the industry." Like the improper tax-and-subsidy scheme in *West Lynn Creamery*, the Kentucky scheme draws equal taxes from in-state and out-of-state interests, alike. In both schemes, the taxes are placed into a segregated fund, and used to provide a subsidy that benefits only in-state interests, and not out-of-state interests. Either way, the in-state business enjoys a price advantage that is unavailable to the out-of-state business. And under either arrangement, the out-of-state interests are directly subsidizing that benefit. In short, as in *West Lynn Creamery*, "the

money is taken and returned rather than simply left with the favored in-state taxpayer in the first place." *Id.* at 211 (Scalia, J., concurring). The only difference is how the money is returned: Instead of returning the money by writing a check to the in-state taxpayer, Kentucky returns the money by paying a cost on behalf of the in-state taxpayer—essentially paying the favored taxpayer's rent directly to the landlord, instead of handing the taxpayer the rent money.

That distinction, too, makes no practical difference. A subsidy is a subsidy. There is no practical or economic difference between a subsidy in the form of a cash payment to an in-state interest and a subsidy in the form of paying a cost on the in-state interest's behalf. Thus, even under the narrowest interpretation of Dormant Commerce Clause principles—a "rule that honors the holdings of ... past decisions but declines to extend the rationale that produced those decisions any further," *id.* at 207-08 (Scalia, J., concurring)—the Kentucky tax-and-subsidy scheme should be struck for the same reason as the virtually identical scheme in *West Lynn Creamery*.

This practical conclusion is reinforced by the principles underlying *West Lynn Creamery* and other Dormant Commerce Clause cases. The taxing schemes that this Court has disapproved—whether "paradigmatic" or more "ingenious," *id.* at 193, 201—have all shared several features. In each, local producers benefit in the marketplace because their out-of-state competitors suffer price-increasing costs. The discrimination artificially sustains production by in-state producers who are less efficient than their out-of-state counterparts.

Investment is skewed towards the state because of the "distorting effects on the geography of production." *Id.* at 193. Prices rise. And the benefits of our "unitary national market" are lost. *Id.*

From the perspective of all the players—the state that collects and distributes the funds, the out-of-state interests that pay the tax without deriving any benefit, the in-state interests that reap all the benefit, and the consumers who pay more—Kentucky's scheme displays all the attributes that this Court has found objectionable. The effect on the national market is the same whether the subsidy to in-state activities comes in the form of a cash payment or cost abatement.

Kentucky's scheme also exhibits another attribute that this Court emphasized in *West Lynn Creamery*. It is an attribute that underscores why an integrated scheme like Kentucky's (one funded by earmarked funds derived in large part from out-of-state interests) is more troubling than a pure subsidy of the sort that is ordinarily permissible (a subsidy drawn from general revenues). A pure subsidy, this Court observed, reflects a legislative judgment that the state should make an investment in a particular industry. Because the funds derive from the entire state tax base, the state could not make that decision without building a broad political consensus. *Id.* at 200. In contrast, the burden of the tax-and-subsidy schemes both here and in *West Lynn Creamery* falls entirely on the unrepresented, out-of-state interests. *See id.* at 199 n.15; *id.* at 211 (Scalia, J., concurring); *see also New Energy*, 486 U.S. at 278; *Hughes*, 426 U.S. at 809-10.

This case presents a vivid illustration of the phenomenon. The Kentucky Legislature "mollified" the very group that would ordinarily have opposed the tax most vociferously. *West Lynn Creamery*, 512 U.S. at 200. Cable supported the new tax on its services precisely because the net effect of the scheme was to increase the costs of the political (and geographic) outsider relative to cable. Just as in *West Lynn Creamery*, "when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse." *Id.*

The Court of Appeals ignored all of this teaching from this Court's prior jurisprudence. It did so in part because it concluded that Kentucky was not actually making any payment on cable's behalf. The Court of Appeals correctly observed that "[s]tates and local government are under no mandate to charge for the use of local rights-of-way." App. 14a. But it was flatly wrong when it concluded that "the state has simply prevented localities from mulcting cable companies through franchise fees, and substituted a uniform state taxation scheme." App. 17a.

This assertion elides both the economic and political realities of the taxing scheme, in defiance, yet again, of this Court's instruction that courts must not be "so rigid as to be controlled by the form by which a State erects barriers to commerce," and cannot "divorce" components of an integrated scheme that, as a practical matter, are inseparable. *West Lynn Creamery*, 512 U.S. at 201. Politically, the Kentucky Legislature did not develop a consensus that local governments should

no longer receive compensation for their rights-of-way. That would have required legislators to fend off fierce opposition from local governments, which depend on that income stream both to cover the costs of digging up roads and maintaining utility poles, and to fund other services.[6] Instead, the Legislature merely agreed to change they way in which local governments receive compensation for use of their rights-of-way.

Accordingly, the state merely assumed the role of collection agent for local government franchise fees. The state collects the money from cable and satellite alike, puts it in a segregated fund, and then shifts the very same funds to the local governments in an amount sufficient to replace cable's franchise fees.

B. The Court of Appeals Failed to Recognize that It Is Impermissible to Favor Firms that Make Heavy In-State Investments over Firms that Do Not.

The Court of Appeals' second mistake was to

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[6] The Court of Appeals questioned the complaint's allegation that franchise fees compensate local governments for real economic costs associated with cable's method of distribution. App. 14a-15a. It should be obvious that renting municipal real estate is a transfer of value to the lessee (worth billions of dollars nationwide) and that digging up the roads is not exactly nuisance-free to the citizens. Thus, franchise fees are "essentially a form of rent: the price paid to rent use of public right-of-ways." *City of Dallas v. FCC*, 118 F.3d 393, 397-98 (5th Cir. 1997). In any event, this is not the sort of question that could be resolved on a motion to dismiss.

conclude that Kentucky's decision to favor cable over satellite is not discrimination against "interstate commerce." The court began with the assertion that television programming delivered by cable and television programming delivered by satellite are "two 'goods'" that "are distinct, consisting of two very different means of delivering broadcasts." App. 16a. From that premise, the Court of Appeals opined that, unlike in *West Lynn Creamery*, "the 'purpose and effect' of the tax and subsidy" was not "'to divert market share' from an out-of-state good to an *identical* in-state good," *id.* (quoting *West Lynn Creamery*, 512 U.S. at 203); rather, Kentucky was simply discriminating against a "particular ... *method*[] of operation" within the state, which is permissible, *id.* (citing *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978)) (emphasis added).

The court's premise is flawed. Cable and satellite are not two "distinct" goods or services. This Court has held that parties are "similarly situated" as long as they compete in the same market, even if their products have different characteristics. *See Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 298 (1997). Under the correct analysis, what matters is not the mode of delivery, but the fact (as the complaint alleges) that cable and satellite are competing providers of the same service: multichannel video programming. Consumers are paying for the television programs. Kentucky, itself, has confirmed as much by imposing sales and revenues taxes on all "multichannel video programming service," which it defines to encompass "cable service and satellite broadcast" as indistinct services. KRS §§ 136.604, 136.616, 136.602(8).

Had the Court of Appeals not exaggerated the difference between cable and satellite, it would have been forced to conclude that Kentucky's discrimination is against interstate commerce. Petitioners can prove a Dormant Commerce Clause violation simply by demonstrating that Kentucky favors cable over satellite because cable transmission involves greater local economic activity, or, put another way, because cable uses a conduit that entails significantly greater investments and expenditures in the state.

That is what this Court means when it emphasizes that a state can violate the Dormant Commerce Clause when it discriminates against commercial activity for having "some interstate element," *Boston Stock Exch.*, 429 U.S. at 332 n.12, or when it puts in place "regulatory measures designed to benefit in-state *economic interests* by burdening out-of-state competitors," *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996) (emphasis added and internal quotation marks omitted); *see id.* at 330-33 (resident ownership of stock in corporations with out-of-state income); *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564 (1997) (in-state accommodations for out-of-state residents); *Westinghouse Elec.*, 466 U.S. at 403 (in-state business's exportation through out-of-state ports); *Maryland v. Louisiana*, 451 U.S. at 774-75 (in-state exploration and production of gas); *see also Cuno*, 386 F.3d 738 (locating machinery and equipment in another state).

This Court's analysis in *Boston Stock Exchange* illustrates the principle. The case involved a New York tax on stock transactions made within the state. 429 U.S. at 330-31. On certain stock

transactions, the law imposed a different tax depending upon the location of the exchange: a transaction through an out-of-state exchange would incur a higher tax than one through an in-state exchange. *Id.* The discriminatory tax protected the in-state infrastructure and tax base (the New York Stock Exchange) at the expense of the out-of-state infrastructure and tax base (emerging competitors like the Boston Stock Exchange). The state courts construed the protectionism as discrimination between two distinct kinds of interstate commerce, much as the Court of Appeals did here. *Id.* at 333.

This Court accepted that characterization, but still concluded that the tax impermissibly discriminated against interstate commerce. The evil, this Court held, was that "[t]he State is using its power to tax an in-state operation as a means of *requiring [other] business operations to be performed in the home State.*" *Id.* at 336 (emphasis added and internal quotation marks omitted).

Kentucky's scheme has a similar effect. Television programming that travels through local cables, and involves considerable local business activity and investment, gets the benefit of a subsidy; television programming that travels through outer space, and involves minimal local activity, gets no subsidy and is subject to a higher effective tax rate. The statute's purpose is to encourage the local activity. Here, as in *Boston Stock Exchange*, "[t]his diversion of interstate commerce and diminution of free competition in [television programming] sales are wholly inconsistent with the free trade purpose of the

Commerce Clause." *Id.*

C. The Court of Appeals Erred in Holding that a Protectionist Motive Can Be Excused if It Might Be Accompanied by Other Benign Motives.

The Court of Appeals' third mistake is the most far-reaching of all. The Court of Appeals acknowledged that "*a* purpose of the [Kentucky tax law] might have been to aid the cable industry rather than the satellite industry because the former has a larger in-state presence than the latter," but it excused the protectionist motive on the ground that "there were clearly *many other* purposes." App. 18a (emphases in original). The court then proceeded to posit a variety of possible purposes that "Kentucky may have wished to" achieve, even while acknowledging that "[n]one of these reasons are explicitly given by Kentucky in support of the [tax statute]." *Id.* The mere "possibility that [these hypothetical motives] in some way motivated the Kentucky legislature's actions" was enough to validate the discriminatory purpose. *Id.*

This notion—that a discriminatory state motive may be excused because one can hypothesize possible additional benign motives—is flatly inconsistent with this Court's precedents. If a taxing scheme is discriminatory in either purpose or effect, this Court has consistently required states to demonstrate that the discrimination is *necessary* to achieve a legitimate, non-discriminatory purpose. *See Granholm v. Heald*, 544 U.S. 460, 489 (2005); *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 352-53

(1977). This strict scrutiny applies whenever a statute discriminates in purpose or effect, because preventing states from purposely discriminating against interstate commerce is one of the Dormant Commerce Clause's fundamental purposes. *Cf. Maine v. Taylor*, 477 U.S. 131, 138 (1986) (noting that a lesser showing is required only when a scheme is not discriminatory in purpose or effect). By relying on hypothesized legislative purposes to uphold the Kentucky statute, the Court of Appeals substituted the laxest form of rational-basis review for the strict scrutiny that is required.

CONCLUSION

For these reasons, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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APPENDICES

APPENDIX

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

DIRECTV, INC. and ECHOSTAR SATELLITE L.L.C., *Plaintiffs-Appellants*,	
v.	No. 06-5523
MARK TREESH, COMMISSIONER FOR THE DEPARTMENT OF REVENUE FOR THE STATE OF KENTUCKY, *Defendant-Appellee.*	

Appeal from the United States District Court for the Eastern District of Kentucky at Frankfort.
No. 05-00024—Karen K. Caldwell, District Judge.

Argued: January 23, 2007

Decided and Filed: May 31, 2007

Before: BOGGS, Chief Judge; and MERRITT and MOORE, Circuit Judges.

COUNSEL

ARGUED: Pantelis Michalopoulos, STEPTOE & JOHNSON, Washington, D.C., for Appellants. Douglas M. Dowell, OFFICE OF LEGAL SERVICES FOR REVENUE, Frankfort, Kentucky, for Appellee. **ON BRIEF:** Pantelis Michalopoulos, Lincoln L. Davies, Mark F. Horning, STEPTOE & JOHNSON, Washington, D.C., Kenneth S. Handmaker, Bradley E. Cunningham, MIDDLETON REUTLINGER,

Louisville, Kentucky, for Appellants. Douglas M. Dowell, Laura M. Ferguson, OFFICE OF LEGAL SERVICES FOR REVENUE, Frankfort, Kentucky, for Appellee. Burt A. Braverman, Timothy P. Tobin, COLE, RAYWID & BRAVERMAN, Washington, D.C., Jackson W. White, Lexington, Kentucky, for Amicus Curiae.

OPINION

BOGGS, Chief Judge. Directv, Inc. and Echostar Satellite L.L.C., collectively "the satellite companies," appeal from the district court's dismissal of their claims against Mark Treesh, the Commissioner of the Department of Revenue for the state of Kentucky. The satellite companies seek a permanent injunction against certain provisions recently added to Kentucky's revenue statutes that afford cable television operators credits and other relief from state taxes assessed against both cable companies and the satellite companies. The satellite companies contend that these credits unconstitutionally discriminate against interstate commerce in violation of the Commerce Clause of Article I of the Constitution. Because we find no constitutional violation, we affirm the judgment of the district court.

I

a. The Satellite and Cable Companies

The satellite companies provide multi-channel video programming to subscribers by means of satellites stationed above the Earth. The federal government auctioned the right to transmit on

certain electromagnetic frequencies, and the satellite companies paid more than $700 million for these rights. The satellite companies allege that they have further invested more than $1 billion in building, insuring, and launching their satellites. Subscribers in Kentucky receive the signals from these satellites by means of small satellite dishes mounted on or near their houses. According to their complaint, the satellite companies "employ no infrastructure in the State to transmit their signal directly to the subscriber and do not use public rights-of-way in providing service." The district court noted, however, that according to the *amicus curiae* brief of the Kentucky Cable Television Association ("KCTA"), the satellite companies do have "local receiving facilities" on the ground in Kentucky, which receive the signals of local broadcast stations and include them in their offerings with the channels sent by satellite. In their complaint, the satellite companies state that Directv has two sales employees in Kentucky and that EchoStar has six sales employees in Kentucky. The district court noted that, according to the KCTA, the satellite companies employ a "legion" of local contractors in Kentucky to sell their services and receiving dishes.

Cable companies, on the other hand, provide multi-channel video programming by means of cable networks located in Kentucky. Cable systems receive the programming that they retransmit to subscribers at local cable headends. The cable headends then transmit the programming to Kentucky subscribers by way of cables laid in trenches in or along roads or hung on utility poles in the state and connected to the subscribers' television sets and set-top boxes. In their

complaint, the satellite companies assert that cable companies must obtain local government permission to use roads and other rights-of-way in order to lay or string cable connecting their local distribution facilities to the subscribers' homes. Local governments typically provide this permission by franchise agreements and permits granted to the cable companies. The satellite companies assert that in return for permission to use public rights-of-way, the cable companies pay a franchise fee to the applicable local government that is typically five percent of gross revenue within the franchise area. The satellite companies characterize the franchise fee as "compensation to the local government for valuable rights granted by the franchise." The satellite companies allege that cable operators have a "strong local presence in Kentucky due to the employment of numerous Kentucky residents and the location of numerous offices and facilities within the state to provide service." Finally, the satellite companies allege that when a customer wishes to purchase a subscription to multi-channel television service, there are basically only two choices: cable or satellite.

b. The Changes to Kentucky's Tax Law

In March 2005, Kentucky amended its tax laws. *See* 2005 Ky. Acts 168, Ky. H.B. No. 272, 2005 Regular Session (2005) (the "2005 amendments") (relevant provisions codified at various sections of Chapter 136 of the Kentucky Revised Statutes).

Prior to the 2005 Amendments, neither the cable companies nor the satellite companies were required to pay Kentucky state sales tax. In addition, pursuant to § 602(a) of the federal

Telecommunications Act of 1996, the satellite companies, but not the cable companies, were and are exempt from all local taxes and fees. Pub. L. No. 104-104, Title VI, § 602(a), 110 Stat. 144(a) (1996) (reprinted at 47 U.S.C. § 152, historical and statutory notes). Nevertheless, the Telecommunications Act explicitly reserves to states the powers the states themselves had to tax satellite companies. *Ibid.* Meanwhile, as stated above, the cable companies paid franchise fees to local governments.

The Kentucky legislature passed the 2005 Amendments in order to provide "a fair, efficient, and uniform method for taxing communications services sold" in Kentucky and to simplify "an existing system that includes a myriad of levies, fees, and rates imposed at all levels of government." KRS § 136.600(1), (3). The 2005 amendments became effective on January 1, 2006.

Section 90 of the 2005 Amendments imposes an excise tax on the retail purchase of multichannel video programming service provided to a person whose place of primary use is in the state. KRS § 136.604(1). The amendments define "multichannel video programming service" as "cable service and satellite broadcast and wireless cable service." *Id.* § 136.602(8). The excise tax is 3% of the sales price charged for the service. *Id.* § 136.604(2). Section 96 of the 2005 Amendments imposes a 2.4% tax on a multichannel video programming service provider's gross revenues from service provided to people in Kentucky. *Id.* § 136.616(1), (2)(a). Together, these provisions effectively impose a 5.4% tax on total charges for either cable or satellite.

Section 112 of the 2005 Amendments establishes a gross revenues and excise tax fund. KRS § 136.648(1). All revenues from the taxes described above are to be deposited into this fund. The money in the fund is then to be allocated among the state and its political subdivisions, school districts, and special districts. *Id.* § 136.648(3). Under Section 113 of the 2005 Amendments, every "political subdivision, school district, special district, and sheriff's department" must certify to the Revenue Cabinet the total local franchise fees it collected from multichannel video programming service providers in fiscal year 2005. *Id.* § 136.650(1). This certified amount is then used to determine the monthly portion of the gross revenues and excise tax fund that will be distributed to each subdivision, school district, and special district. The 2005 Amendments provide that each will be assigned a percentage, called the "local historical percentage," which is based on the amount of the subdivision's certified collections as a proportion of the total certified amount of all collections of all parties participating in the fund. In return for their participation in this fund, the subdivisions must agree to relinquish any right to a franchise fee or tax on multichannel video programming services. *Id.* § 136.650(1)(b).

Pursuant to Section 118 of the 2005 Amendments, local governments are prohibited from levying any franchise fee or tax on a multichannel video programming service. KRS § 136.660. If a local government imposes or attempts to impose a franchise fee or tax, the local government may not receive any share of the proceeds of the excise and gross revenues taxes for the period that the imposition occurs. *Id.*

§ 136.660(4). Further, if a provider of a multichannel video programming service actually pays a franchise fee or tax with respect to the service, the provider is entitled to a credit against the state taxes due in the amount of the franchise fee or tax. *Id.* § 136.660(5).

c. The Satellite Companies' Complaint

The satellite companies allege that the provisions of the 2005 Amendments that "afford cable system operators credits against the state excise and gross revenues taxes and relief from franchise fees unconstitutionally discriminate against interstate commerce in violation of the Commerce Clause." The satellite companies ask the court to declare KRS § 136.660(4), (5) unconstitutional. These are the subsections of the 2005 Amendments prohibiting local governments from levying franchise fees and taxes, denying local governments fund proceeds if they levy such fees, and crediting providers of multichannel video programming services for any such fees paid. In effect, they argue that if a state imposes uniform taxes on all multi-channel video programming providers, it also is constitutionally required that the state allow its localities and subdivisions to charge significant franchise fees.

The satellite companies argue that with the new provisions the cable companies receive a tax preference because revenues from the state excise and gross revenues tax are used to pay the franchise fees that cable operators would otherwise have to pay local governments for access to local rights-of-way. This discriminates against interstate commerce because cable companies, which provide service via infrastructure necessarily

located within the state, get the tax preference while satellite companies, which provide service via satellites inherently located outside of the state, get no tax preference. In other words, the cable companies pay the new taxes but get relief from a portion of their operating costs, i.e., the price paid for the right to provide cable service in the franchise area and rights of access to public rights-of-way. The satellite companies pay the new taxes, but receive no relief from their operating costs. According to the satellite companies, this constitutes discrimination against interstate commerce because the burdened entities—the satellite companies—employ inherently out-of-state facilities and have very little in-state infrastructure, while the benefitted entities—the cable companies—employ necessarily expansive in-state facilities to deliver their television service.

II

We review a grant of a Rule 12(b)(6) motion to dismiss *de novo*. *See, e.g., Golden v. City of Columbus*, 404 F.3d 950, 958 (6th Cir.), *cert. denied*, 546 U.S. 1032 (2005). "[A] Rule 12(b)(6) motion should not be granted unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Ricco v. Potter*, 377 F.3d 599, 602 (6th Cir. 2004) (quotation omitted). In reviewing a motion to dismiss, we construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff. *See Evans-Marshall v. Bd. of Educ.*, 428 F.3d 223, 228 (6th Cir. 2005). The defendant has the burden of showing that the plaintiff has failed to state a claim

for relief. *Carver v. Bunch*, 946 F.2d 451, 454-55 (6th Cir. 1991). While all the factual allegations of the complaint are accepted as true, "we need not accept as true legal conclusions or unwarranted factual inferences." *Gregory v. Shelby County*, 220 F.3d 433, 446 (6th Cir. 2000) (citation omitted).

III

The satellite companies first argue that the district court erred by relying on factual assumptions that were neither alleged in their complaint nor consistent with the complaint's allegations. The satellite companies argue that this improperly converted the motion to dismiss into a motion for summary judgment. Specifically, the satellite companies argue that the district court substituted its own factual assumptions, largely drawn from the KCTA *amicus* brief, for the factual allegations in the satellite companies' complaint, and that the district court faulted plaintiffs for not coming forward with evidence to support their allegations.

At some times in its opinion, the district court appears to have made factual assumptions that may be controverted. While the satellite companies alleged that they used no infrastructure whatsoever within the state to deliver programming, the district court found that "the mechanisms by which the ... Satellite Companies deliver programming lie partially outside of Kentucky and partially inside the state." The district court specifically pointed to the receiving dishes for local programming mentioned in the KCTA brief as an example of the in-state infrastructure. Further, the district court faults the

satellite companies for the lack of "evidence in the record" to support the principal places of business of the satellite and cable companies, and the failure of the satellite companies to "presen[t] any other evidence" from which the district court could conclude that cable companies are in-state economic interests.

If the district court's decision were actually predicated upon the above factual findings or the failure of plaintiffs to present the specified evidence, it would have been error. "[U]nder the notice pleading standard of the Federal Rules, courts are reluctant to dismiss colorable claims which have not had the benefit of factual discovery." *Evans-Marshall*, 428 F.3d at 228. Further, it does not appear that the satellite companies were given a "reasonable opportunity to present all material made pertinent to the issue" as required by Fed. R. Civ. P. 12(b) when a district court converts a motion to dismiss into a motion for summary judgment.

The district court's opinion, however, was not clearly predicated upon its additional factual findings or its finding of lack of evidence. Several of the district court's reasons for dismissal were not based on these additional findings. Therefore, ignoring the above flaws in the district court's opinion, the relevant question on appeal is whether the district court properly found that, even accepting all of the facts in the satellite companies' complaint as true, the complaint failed to demonstrate that the 2005 Amendments discriminate against interstate commerce.

IV

The Constitution expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States," U.S. Const. art. I, § 8, cl. 3, and the "negative" or "dormant" aspect of the Commerce Clause implicitly limits a state's right to tax interstate commerce. In *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977), the Court provided a concise exegesis of the dormant aspect of the Commerce Clause:

> [W]e begin with the principle that "[the] very purpose of the Commerce Clause was to create an area of free trade among the several States." *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944). It is now established beyond dispute that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States ... [T]he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States." *Freeman v. Hewit*, 329 U.S. 249, 252 (1946). The Commerce Clause does not, however, eclipse the reserved "power of the States to tax for the support of their own governments," *Gibbons v. Ogden*, 9 Wheat. 1, 199 (1824), or for other purposes ... rather, the Clause is a limit on state power. Defining that limit has been the continuing task of this Court. On various occasions when called upon to make the delicate

> adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case. *E.g., Freeman v. Hewit* .... This case-by-case approach has left "much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457 (1959).

Id. at 328-29.

A tax provision satisfies the requirements of the Commerce Clause if (1) the activity taxed has a substantial nexus with the taxing state; (2) the tax is fairly apportioned to reflect the degree of activity that occurs within the state; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to benefits provided by the state. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The satellite companies only challenge Kentucky's amended tax law on ground (3).

The Commerce Clause "does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry." *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336-37 (1977). The Supreme Court has never precisely delineated the scope of the doctrine that bars discriminatory taxes. The Court has made it clear,

however, that a tax statute's "constitutionality does not depend upon whether one focuses upon the benefitted or the burdened party." *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 273 (1984).

In general, a challenged credit or exemption will fail Commerce Clause scrutiny if it discriminates on its face, or if, on the basis of a "sensitive, case-by-case analysis of purposes and effects," the provision "will in its practical operation work discrimination against interstate commerce," *West Lynn Creamery v. Healy*, 512 U.S. 186, 201 (1994) (citations omitted), by "providing a direct commercial advantage to local business." *Bacchus Imports*, 468 U.S. at 268 (citations omitted). "'Discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality*, 511 U.S. 93, 99 (1994). A state tax provision that discriminates against interstate commerce is invalid unless "it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Id.* at 101 (citation omitted).

A statute found to discriminate against interstate commerce "is virtually *per se* invalid." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) (citation omitted). Once discrimination is shown, the heavy burden to prove the law's validity falls on the state. *See Maine v. Taylor*, 477 U.S. 131, 138 (1986).

On appeal, the satellite companies argue solely that the 2005 Amendments discriminate against interstate commerce in practical effect. *West Lynn Creamery*, 512 U.S. at 201. The satellite companies

complain that what they call the "tax and subsidy" approach, taken by Kentucky in the 2005 Amendments, is a sham. According to the satellite companies, while the Amendments purport to prohibit franchise fees from being assessed against all multi-channel broadcast services, in fact, only cable companies have been required to pay local franchise fees. Therefore, only they will benefit from this provision, while the satellite companies garner no benefit.

As an initial matter, the satellite companies do not contend that if Kentucky had solely imposed an equal state tax on both satellite companies and cable companies, without providing a credit for the cable companies' franchise fees or banning those fees, that such a tax would violate the Commerce Clause. Nor does it appear that Kentucky would have violated the Commerce Clause had it solely banned local governments from imposing franchise fees on cable companies. The nature of the franchise fees are somewhat disputed. As this case is before us on a motion to dismiss, we will accept the contention of the satellite companies that these franchise fees are at least compensatory in part; that they are collected in order to compensate the local governments for the cable companies' use of the rights-of-way, utility poles, etc. However, there is no allegation of any significant cost to the city of providing this access to the cable companies.

States and local government are under no mandate to charge for the use of local rights-of-way; this is readily apparent from the fact that not every road is a toll road. States have wide latitude "to encourage the growth and development of intrastate commerce and industry." *Boston Stock*

Exch., 429 U.S. at 336-37. The provision of access to the state infrastructure free of charge is an acceptable option that the state may exercise.[1] While the Supreme Court has struck down state regulations that charged out-of-state truckers and in-state truckers the same flat fees for the use of the state highways because the in-state truckers use the highways more frequently, *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 282 (1987), there is no indication that states would violate the Commerce Clause by foregoing such fees entirely, even though the lack of such a fee would benefit local truckers more than out-of-state truckers. *See West Lynn Creamery*, 512 U.S. at 199 n.15 ("[I]t is undisputed that States may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads ...." (citing *Zobel v. Williams*, 457 U.S. 55, 67 (1982) (Brennan, J., concurring))).

Yet, as the Court has recognized in *West Lynn Creamery*, a tax and a subsidy, each of which would be constitutional standing alone, might together be unconstitutional. 512 U.S. at 199-200. The satellite companies analogize Kentucky's new taxation regime to the one found to violate the dormant Commerce Clause in *West Lynn Creamery*. In that case, Massachusetts required all milk dealers in the state to contribute to a price equalization fund regardless of whether they bought milk from in-state or out-of-state

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[1] The Court has indicated that even direct monetary subsidies to in-state companies often will not violate the Commerce Clause. *See West Lynn Creamery*, 512 U.S. at 199 n.15.

producers. The state then distributed the proceeds of that fund solely to Massachusetts dairy producers, but not to their out-of-state counterparts. The court found that this violated the Commerce Clause: "Although the tax also applies to milk produced in Massachusetts, its effect on Massachusetts producers is entirely ... offset by the subsidy provided exclusively to Massachusetts dairy farmers." *West Lynn Creamery*, 512 U.S. at 194. Massachusetts argued that either the tax or the subsidy standing alone would be constitutional, therefore, the combination must be constitutional as well. The Court rejected that contention, concluding that, even assuming that each component would be constitutional standing alone, "[b]y conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone." *Id.* at 199-200.

The instant case differs from *West Lynn Creamery* in several important respects. First, the claimed subsidy is not a direct monetary subsidy, but is instead only the right to conduct business and use local rights-of-way without local taxation or fees. Second, in *West Lynn Creamery*, the "purpose and effect" of the tax and subsidy was "to divert market share" from an out-of-state good to an identical in-state good. *Id.* at 203. In this case, however, the two "goods" are distinct, consisting of two very different means of delivering broadcasts. *See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978) (holding that the Commerce Clause does not "protect[] the particular structure or methods of operation in a retail market."). Further, the purposes of the 2005 Amendments include non-market share related goals, such as

simplifying the labyrinthine system of fees cable companies currently face and collecting taxes from the previously untaxed, burgeoning satellite industry.

The "paradigmatic example" of a law that violates the dormant Commerce Clause is the protective tariff, which taxes goods produced in other states but not those produced in-state. *West Lynn Creamery*, 512 U.S. at 193. Such tariffs are so clearly unconstitutional that states hardly ever enact them. *Ibid.* Yet other measures are the functional equivalent of such tariffs, such as enacting a facially neutral tax on all liquor and exempting liquor produced locally from the tax. *Bacchus Imports*, 468 U.S. at 263. In *West Lynn Creamery*, the Court found a tariff disguised as a tax and subsidy. The purpose and effect of that scheme was solely to raise the price of out-of-state milk and lower the price of in-state milk.

The satellite companies' allegations are insufficient to demonstrate that the 2005 Amendments create the functional equivalent of a protective tariff. With the Amendments, the state has simply prevented localities from mulcting cable companies through franchise fees, and substituted a uniform state taxation scheme. It has not otherwise altered any competitive balance among in and out-of-state competitors.

Further, a protective tariff is so clearly problematic because its only possible purpose is to benefit in-state interests at the expense of out-of-state interests—likewise an industry-specific tax and subsidy scheme. *See Note: Functional Analysis, Subsidies, and the Dormant Commerce Clause*, 110 Harv. L. Rev. 1537, 1552-54 (1997).

Unlike a protective tariff, however, the purposes of Kentucky's 2005 Amendments are much more diffuse. While *a* purpose of the Amendments might have been to aid the cable industry rather than the satellite industry because the former has a larger in-state presence than the latter, there were clearly *many other* purposes including assessing some tax against a satellite industry that is rapidly growing, and simplifying the current morass of local taxes and franchise fees that cable companies face. *See Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976) (upholding a state policy clearly motivated in part by a desire to improve the state's environment, despite any concurrent protectionist motivations). The satellite companies' opinion of the 2005 Amendments might be very different had they been subjected to the tangled regime of local taxation and franchise fees, as they certainly could have been absent the special exemption granted to them by the Telecommunications Act. 47 U.S.C. § 152, historical and statutory notes. Beyond that, because satellite and cable television differ significantly in their means of operation, Kentucky may have wished to remove any barriers it had put in place to the continued viability of cable for reasons entirely unrelated to geography—for example, that cable providers often provide internet access as well, that cable providers are more likely to provide public access channels, etc. None of these reasons are explicitly given by Kentucky in support of the Amendments, but the possibility that they in some way motivated the Kentucky legislature's actions is the reason that the Supreme Court has held that the dormant Commerce Clause is intended to protect interstate commerce, and not particular firms engaged in

interstate commerce, or the modes of operation used by those firms. *Exxon Corp.*, 437 U.S. at 126-28; *see also Amerada Hess Corp. v. Director, Div. of Taxation, N.J. Dep't of the Treasury*, 490 U.S. 66, 78 (1989) (holding that the differential tax treatment of "two categories of companies result[ing] solely from differences between the nature of their businesses, [and] not from the location of their activities" does not violate the dormant Commerce Clause.).

We must be cautious about applying the dormant Commerce Clause in cases that do not present the equivalent of a protective tariff. States must be allowed, and even encouraged, to work "to attract business by creating an environment conducive to economic activity." Applying the dormant Commerce Clause to invalidate Kentucky's revenue statute in this case would dramatically increase the clause's scope and limit states' "right to experiment with different incentives to business," *Alexandria Scrap*, 426 U.S. at 817 (Stevens, J., concurring), or to implement "effective and creative programs for solving local problems." *Reeves*, 447 U.S. at 441. Kentucky's banning of local franchise fees can serve many purposes and have many effects other than arguably reducing a cost previously borne by one type of competitor in the marketplace. After a "sensitive ... analysis of [the] purposes and effects" of the 2005 Amendments, we are unable to find that such action "will in ... practical operation work discrimination against interstate commerce." *West*

Lynn Creamery, 512 U.S. at 201.[2]

V

Accordingly, for the reasons set out above, we AFFIRM the district court's grant of Treesh's motion to dismiss.

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[2] Upon appeal, Treesh argues that Congress explicitly approved the type of taxation that Kentucky implemented with the 2005 Amendments. *See* 47 U.S.C. § 152, historical and statutory notes. Congress may authorize state regulation that would otherwise violate the dormant Commerce Clause. *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992). Because we affirm the district court's judgment on other grounds, it is unnecessary for us to decide this question.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
FRANKFORT

CIVIL ACTION NO. 3:05-24

DIRECTV, INC., et al., PLAINTIFFS,

v. **OPINION AND ORDER**

MARK TREESH,
in his official capacity
as Commissioner of the
Department of Revenue, DEFENDANT.

**** **** **** ****

This matter is before the Court on the Motion to Dismiss (Rec. No. 10) filed by the Defendant, Mark Treesh (the "Commissioner"), who has been sued in his official capacity as Commissioner of the Kentucky Department of Revenue. The Plaintiffs, DIRECTV, Inc. and Echostar Satellite, LLC (the "Satellite Companies"), argue that recently enacted Kentucky corporate tax provisions unconstitutionally discriminate against interstate commerce by benefitting cable television operators (the "Cable Companies") and burdening the Satellite Companies. For the following reasons, the Court will GRANT the Motion to Dismiss.

I. FACTS.

A. The Satellite Companies.

The Plaintiff, DIRECTV is organized and headquartered in California. (Rec. No. 1, Complaint ¶ 6). The Plaintiff, EchoStar Satellite, LLC, is organized and headquartered in Colorado. (Rec. No. 1, Complaint ¶ 7). Neither plaintiff has

any offices located in Kentucky. (Rec. No. 1, Complaint ¶ 17).

The Satellite Companies provide multi-channel video programming to subscribers by means of satellites stationed above the Earth. (Rec. No. 1, Complaint ¶ 13). The federal government grants the Satellite Companies the right to transmit in certain electromagnetic frequencies from satellites located at certain orbital positions. (Rec. No. 1, Complaint ¶ 14). Subscribers in Kentucky then receive the signal from these satellites by means of a small satellite dish mounted on or near their house. (Rec. No. 1, Complaint ¶ 15).

In their Complaint, the Satellite Companies state that, because they do not use any public rights-of-way, they are not required to obtain franchise rights from local governments to operate in Kentucky. (Rec. No. 1, Complaint ¶ 16). In their brief as *amicus curiae*, the Kentucky Cable Telecommunications Association (the "KCTA") asserts that the Satellite Companies transmit the programming of local broadcast stations and that, in order to do this, they must have "local receive facilities" on the ground in Kentucky to receive the signals of local broadcast stations. (Rec. No. 28 Brief for KCTA as *Amicus Curiae* at 18 n.7).

The Satellite Companies state that DIRECTV has two sales employees in Kentucky and EchoStar has six sales employees in Kentucky. (Rec. No. 1, Complaint ¶ 17). The KCTA asserts that, in addition to regular employees, the Satellite Companies employ a "legion" of local contractors in Kentucky to sell their services and receive dishes. (Rec. No. 28 Brief for KCTA as *Amicus Curiae* at 18 n.7).

B. The Cable Companies.

The Cable Companies provide multi-channel video programming by means of cable networks located in Kentucky. (Rec. No. 1, Complaint ¶ 2). The Cable Companies receive programming at cable headends located in Kentucky and then transmit the programming to Kentucky subscribers by way of cables laid in trenches in or along roads or hung on utility poles in the state and connected to the subscribers' television sets and set top boxes. (Rec. No. 1, Complaint ¶ 18).

In their Complaint, the Satellite Companies assert that the Cable Companies must obtain local government permission to use roads and other rights-of-way in order to lay or string cable connecting their local distribution facilities to the subscribers' homes. (Rec. No. 1, Complaint ¶ 19). According to the Satellite Companies, local governments grant this permission by franchise agreements and permits granted to the Cable Companies. (Rec. No. 1, Complaint ¶ 19). The Satellite Companies assert that, in return for permission to use public rights-of-way, the Cable Companies pay a franchise fee to the applicable local government that is typically five percent of gross revenue within the franchise area. (Rec. No. 1, Complaint ¶ 20).

The KCTA asserts that the Cable Companies transmit national satellite-delivered programming, broadcast television signals and regional cable television network programming. In doing so, they rely on satellite transmissions, microwave relay stations and interstate fiber optic communications lines that beam their transmissions across state boundaries. (Rec. No. 28 Brief for KCTA as *Amicus*

Curiae at 15-17). *See also, Int'l Cablevision, Inc. v. Sykes*, 75 F.3d 123, 126 (2d Cir. 1996) ("Cablevision sells cable television programming which it delivers to its customers from the system headend via coaxial ground cable. The headend has parabolic or other appropriately shaped antennas for receiving satellite-delivered program signals, high-gain directional antennas for receiving distant TV broadcast signals, directional antennas for receiving local signals, machines for playback of taped programming and commercial insertion, and studios for local origination and community access programming.") (quotations and citation omitted).

The KCTA also asserts that the three largest cable companies in Kentucky are headquartered in states other than Kentucky. According to the KCTA, these companies are Insight Communications which is headquartered in New York, Adelphia Communications which is headquartered in Greenwood Village, Colorado and Charter Communications which is headquartered in St. Louis. (Rec. No. 28 Brief for KCTA as *Amicus Curiae* at 16 n.6).

The Satellite Companies assert that the Cable Companies employ numerous Kentucky residents and have numerous offices and facilities in Kentucky. (Rec. No. 1, Complaint ¶ 21). The Satellite Companies assert that they are competitors of the Cable Companies in the market for multichannel video programming distribution. (Rec. No. 1, Complaint ¶ 22). According to the Satellite Companies, both the Cable Companies and the Satellite Companies sell various packages of television channels including local television stations and cable programming. (Rec. No. 1,

Complaint ¶ 22).

C. Situation Prior to the 2005 Amendments.

The legislation that is the subject of the Satellite Companies' Complaint was enacted by the Kentucky General Assembly in March, 2005. 2005 KY H.B. 272, Kentucky H.B. No. 272, 2005 Regular Session (Ky. 2005) (the "2005 Amendments") (relevant provision codified at various sections of Chapter 136 of the Kentucky Revised Statutes).

Prior to the 2005 Amendments, neither the Cable Companies nor the Satellite Companies were required to pay Kentucky state sales tax. In addition, pursuant to § 602(a) of the federal Telecommunications Act of 1996, the Satellite Companies were and are exempt from local taxes and fees. Pub. L. No. 104-104, Title VI, § 602(a), 110 Stat. 144(a) (1996) (reprinted at 47 U.S.C. § 152, historical and statutory notes). Nevertheless, the Telecommunications Act explicitly permits states to impose a tax on the Satellite Companies and to distribute the proceeds from the tax to local governments. Pub. L. No. 104-104, Title VI, § 602(c), 110 Stat. 144(a) (1996) (reprinted at 47 U.S.C. § 152, historical and statutory notes). Meanwhile, as discussed above, the Cable Companies paid franchise fees to local governments in return for franchise agreements permitting them to use road and other rights-of-way to lay or string cable. (Rec. No. 1, Complaint ¶ 19).

D. The 2005 Amendments.

With the 2005 Amendments, the legislature sought to provide "a fair, efficient and uniform

method for taxing communications services sold in this Commonwealth" and to simplify "an existing system that includes a myriad of levies, fees and rates imposed at all levels of government." 2005 KY H.B. 272 § 88(1), (3) (codified at KRS § 136.600(1), (3)). The relevant provisions of the 2005 Amendments became effective on January 1, 2006. 2005 KY H.B. 272 § 168.

1) Section 90—New Excise Tax on Purchasers.

Section 90 of the 2005 Amendments imposes an excise tax on the retail purchase of multichannel video programming service provided to a person whose place of primary use is in the state. 2005 KY H.B. 272 § 90(1) (codified at KRS § 136.604(1)). The amendments define "multichannel video programming service" as "cable service and satellite broadcast and wireless cable service." 2005 KY H.B. 272 § 89(8) (codified at KRS § 136.602(8)). The excise tax is three percent of the sales price charged for the service. 2005 KY H.B. 272 § 90(2) (codified at KRS § 136.604(2)). The amendments require the provider to collect the excise tax from the purchaser. 2005 KY H.B. 272 § 91(1) (codified at KRS § 136.606(1)).

2) Section 96—New Gross Revenue Tax on Providers.

Section 96 of the 2005 Amendments imposes a 2.4 percent tax on a multichannel video programming service provider's gross revenues. 2005 KY H.B. 272 § 96(1), (2)(a) (codified at KRS § 136.616(1), (2)(a)). Unlike the excise tax, the provider is prohibited from collecting the 2.4 percent gross revenue tax directly from the

purchaser or to separately state the tax on the bill to the purchaser. 2005 KY H.B. 272 § 96(3) (codified at KRS § 136.616(3)).

3) Section 112—Creation of Designated Fund.

Section 112 of the 2005 Amendments establishes a gross revenues and excise tax fund. 2005 KY H.B. 272 § 112(1) (codified at KRS § 136.648(1)). All revenue from the gross revenues and excise tax imposed under Sections 90 and 96 are to be deposited into the fund. 2005 KY H.B. 272 § 112(3) (codified at KRS § 136.648(3)). The money in the new fund is to be allocated among the state, political subdivisions, school districts and special districts. 2005 KY H.B. 272 § 112(3) (codified at KRS § 136.648(3)).

4) Section 113—Portion of Designated Fund Distributed to Local Governments.

Under section 113 of the 2005 Amendments, each local government must certify to the Revenue Cabinet the local franchise fees it collected from communication services and multichannel video programming service providers and other fees collected to fund public educational and government access programming in Fiscal Year 2005. 2005 KY H.B. 272 § 113(1) (codified at KRS § 136.650(1)). This certified amount is then used to determine the monthly portion of the gross revenues and excise tax fund that will be distributed to each local government. 2005 KY H.B. 272 § 113(2) (codified at KRS § 136.650(2)).

Specifically, the amendments provide that each local government will be assigned a percentage, called the "local historical percentage," which is

based on the amount of the local government's certified collections as a ratio of the total certified amount of collections of all parties participating in the fund. 2005 KY H.B. 272 § 113(2)(a) (codified at KRS § 136.650(2)(a)). Each month, each local government is to be distributed an amount equal to its local historical percentage multiplied by the "monthly hold harmless amount." 2005 KY H.B. 272 § 113(2)(d) (codified at KRS § 136.650(2)(d)). The "monthly hold-harmless amount" is $3,034,000 which represents 1/12 of the total potential collections into the fund. 2005 KY H.B. 272 § 113(2)(c) (codified at KRS § 136.650(2)(c)).

In return for their participation in this fund, the local governments agree to relinquish any right to a franchise fee or tax on multichannel video programming services. 2005 KY H.B. 272 § 113(1)(b) (codified at KRS § 136.650(1)(b)).

5) Section 118—Local Franchise Fees Prohibited and Potential Tax Credit.

Pursuant to Section 118 of the 2005 Amendments, local governments are prohibited from levying any franchise fee or tax on a multichannel video programming service or from collecting any franchise fee or tax from providers or purchasers of multichannel video programming services. 2005 KY H.B. 272 § 118(1) (codified at KRS § 136.660). A "franchise fee or tax" is defined as:

> (a) any tax, charge, or fee, that is required by ordinance or agreement to be paid to a political subdivision by or through a provider, in its capacity as a provider, regardless of whether the tax, charge, or

> fee, is: 1) designated as a franchise fee, sales tax, excise tax, user fee, occupancy fee, subscriber charge, license fee, or otherwise; 2) measured by the amounts charged for services, the type or amount of equipment or facilities deployed, or otherwise; 3) intended as compensation for the use of public or private rights-of-way, the right to conduct business, or otherwise; or 4) permitted or required to be separately stated on the purchaser's bill; or
>
> (b) Any in-kind payment of property or services that is required to be furnished by a provider by any ordinance that is enacted or agreement that is entered into after January 1, 2006.

2005 KY H.B. 272 § 118(2) (as codified at KRS § 136.660(2)).

If a local government imposes or attempts to impose a franchise fee or tax, the local government may not receive any share of the proceeds of the taxes levied by Sections 90 or 96 for the period that the imposition or attempt occurs. 2005 KY H.B. 272 § 118(4) (codified at KRS § 136.660(4)). Further, if a provider of a multichannel video programming service actually pays a franchise fee or tax with respect to the service, the provider is entitled to a credit in the amount of the franchise fee or tax against the amount due under Sections 90 or 96. 2005 KY H.B. 272 § 118(5) (codified at KRS § 136.660(5)).

E. The Satellite Company's Complaint.

With their Complaint, the Satellite Companies argue that the provisions of Section 118 of the 2005

Amendments that "afford cable system operators credits against the state excise and gross revenues taxes and relief from franchise fees unconstitutionally discriminate against interstate commerce in violation of the Commerce Clause." (Rec. No. 1, Complaint, ¶ 32). The Satellite Companies ask the Court to declare unconstitutional only subsections 1, 4 and 5 of Section 118. (Rec. No. 1, Complaint, Prayer for Relief ¶ 1).

The Satellite Companies argue that, with the new provisions, the Cable Companies receive a tax preference because "revenues from the state excise and gross revenues tax [fund are used] to pay the franchise fee cable operators would otherwise have to pay local governments for access to local rights-of-way." (Rec. No. 13, Response at 3). The Satellite Companies argue that the tax provisions discriminate against interstate commerce because:

> [T]he availability of the tax preference depends on the geographic location of the facilities used to distribute television service. Cable companies, who provide service by local cable networks and pay franchise fees to local governments for that privilege, receive the preference. Satellite television companies, who provide services by satellites which are necessarily located out-of-state and pay the federal government for that privilege, do not receive the preference.

(Rec. No. 13, Response at 2).

> So, by paying the new taxes, cable systems defray one of their significant costs of

> doing business. By contrast, no benefit is available to satellite providers, because of the out-of-state character of their facilities. While the costs of building satellite systems and securing spectrum and orbital locations are substantial, these resources are not within the power of any municipality to give. Thus, the satellite providers receive no comparable benefits to those received by cable systems, despite making the same payments.

(Rec. No. 1, Complaint ¶ 5).

In other words, the Satellite Companies argue that, in return for paying the new taxes, Cable Companies receive a corresponding relief from a portion of their operating costs, i.e., the price paid for the right to provide cable service in the franchise area and for rights of access to public rights-of-way. The Satellite Companies, on the other hand, pay the new taxes but receive no relief from their operating costs. This constitutes discrimination against interstate commerce according to the Satellite Companies because the burdened entities—the Satellite Companies—employ out-of-state facilities to distribute television service, while the benefited entities—the Cable Companies—employ in-state facilities to distribute television service.

Thus, it appears that the Satellite Company's complaint is not just with the prohibition against local franchise fees found in Section 118 of the 2005 Amendments but is instead also with the new state taxes imposed under Sections 90 and 96 and the tax distribution system imposed under Section 113 by which a portion of the new taxes are

distributed to local governments in an amount proportionate to the amount the local governments previously collected in franchise fees. The Court will consider all of these provisions in determining whether Kentucky's new tax provisions violate the dormant Commerce Clause.

II. ANALYSIS.

On a motion to dismiss made pursuant to Fed. R. Civ. P. 12(b)(6), "the factual allegations in the complaint must be regarded as true. The claim should not be dismissed unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Scheid v. Fanny Farmer Candy Shops, Inc.*, 859 F.2d 434, 436 (6th Cir. 1988) (quoting *Windsor v. The Tennessean*, 719 F.2d 155, 158 (6th Cir. 1983)).

A. The Dormant Commerce Clause.

The Commerce Clause of the United States Constitution authorizes Congress to "regulate Commerce ... among the several States...." U.S. Const. art. I, § 8 cl. 3. "[T]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *Westinghouse Electric Corporation v. Tully*, 466 U.S. 388, 402 (1984) (citation omitted). Thus, "[a]lthough the Commerce Clause is by its text an affirmative grant of power to Congress to regulate interstate and foreign commerce, the Clause has long been recognized as a self-executing limitation on the power of the States to enact laws imposing substantial burdens on such commerce." *South-Central Timber Dev. Inc. v. Wunnicke*, 467 U.S. 82, 87 (1984).

Favoring in-state economic interests over out-of-state economic interests is a classic means by which a state may discriminate against interstate commerce. In fact, the Supreme Court has repeatedly stated that "discrimination," for purposes of the Commerce Clause, "simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality of Ore.*, 511 U.S. 93, 99 (1994). Pursuant to these cases, states may not provide "a direct commercial advantage to local business." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). This is because, "[p]ermitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses would invite a multiplication of preferential trade areas destructive of the free trade which the Clause protects." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977). Such a result would be contrary to the fundamental objective of the dormant Commerce Clause which is to "preserv[e] a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors." *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 299 (1997).

A statute can discriminate against out-of-state interests in three different ways: (1) it may be facially discriminatory; (2) it may have a discriminatory intent; or (3) it may have a discriminatory effect. *Amerada Hess Corp. v. Director, Division of Taxation, New Jersey*, 490 U.S. 66, 75 (1989); *Eastern Ky. Resources v. Fiscal Court of Magoffin County*, 127 F.3d 532, 540 (6th

Cir. 1997) (citing *Wyoming v. Oklahoma*, 502 U.S. 437, 454-55 (1992)).

"State laws that discriminate on their face against interstate commerce are presumptively invalid." *Id.* at 532 (citing *Oregon Waste Sys. Inc.*, 511 U.S. at 99-100). "This is because these laws are almost always reflective of a state's attempt to isolate itself from the national economy and to protect local actors." *Id.* (citing *Fort Gratiot Sanitary Landfill Inc. v. Michigan Dep't of Natural Resources*, 504 U.S. 353, 361 (1992)).

B. Statute does not Facially Discriminate against Interstate Commerce.

Here, the statute does not discriminate on its face against out-of-state interests. The language of the new tax provisions do not distinguish between in-state and out-of-state economic interests. Instead, each of the relevant provisions evenhandedly applies to any multichannel video programming service provider. Accordingly, "there is no explicit discriminatory design to the tax." *Amerada*, 490 U.S. at 76.

C. The Satellite Companies Cannot Show that the Statute has a Discriminatory Purpose.

"It is axiomatic that a state law that purposefully discriminates against out-of-state interests is unconstitutional." *Eastern Ky. Resources*, 127 F.3d at 541. "The party challenging the validity of the regulation has the burden of demonstrating that the regulation has a discriminatory purpose." *Id.* "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature

undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislation. In such cases, we have followed their plain meaning." *Id.* (quoting *Perry v. Commerce Loan Co.*, 383 U.S. 392, 400 (1966)).

The only evidence in the record regarding the Kentucky legislature's intent with regard to the relevant provisions of the 2005 Amendments is found in the statute itself, which states that the new tax and distribution system:

> 1) Addresses an important state interest in providing a fair, efficient and uniform method for taxing communications services sold in this Commonwealth;
>
> 2) Overcomes limitations placed upon the taxation of communications service by federal legislation that has resulted in inequities and unfairness among providers and consumers of similar services in the Commonwealth;
>
> 3) Simplifies an existing system that includes a myriad of levies, fees and rates imposed at all levels of government, making it easier for communications providers to understand and comply with the provisions of the law;
>
> 4) Provides enough flexibility to address future changes brought about by industry deregulation, convergence of service offerings, and continued technological advances in communications; and
>
> 5) Enhances administrative efficiency for communications service providers, the

> state, and local governments by drastically reducing the number of returns that must be filed and processed on an annual basis.

2005 KY H.B. 272 § 88 (codified at KRS § 136.600). This language does not indicate any intent to protect local economic actors or to economically isolate the Commonwealth from the rest of the nation. *Eastern Ky. Resources*, 127 F.3d at 542. The Satellite Companies have presented no evidence that the new tax and distribution system was "motivated by an intent to confer a benefit upon local industry not granted to out-of-state industry." *Amerada*, 490 U.S. at 76.

Furthermore, even if the Satellite Companies could produce evidence that the legislature intended to burden them and to benefit the Cable Companies, this would not establish an intent to discriminate against interstate commerce. For reasons that will be explained further below, discrimination against satellite-delivered programming in favor of cable-delivered programming does not constitute discrimination against interstate commerce.

D. Statute Does not Have a Discriminatory Effect.

As to whether the new tax provisions have a discriminatory effect, for purposes of this motion, the court will presume that the new taxes and the distribution system imposed by the 2005 Amendments have the effect of burdening the Satellite Companies and benefitting the Cable Companies. Such an effect is, of course, irrelevant under the dormant Commerce Clause unless it constitutes discrimination against interstate

commerce. The Satellite Companies argue that, discrimination against them in favor of the Cable Companies has the effect of discriminating against interstate commerce because the Satellite Companies are "out-of-state" economic interests while the Cable Companies are "in-state" economic interests.

The plaintiffs bear the initial burden of showing that a statute has a discriminatory effect on interstate commerce. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979). If the plaintiffs meet that burden, the Commissioner bears the burden of establishing that the challenged government action "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Oregon Waste Sys., Inc.*, 511 U.S. at 101.

The Satellite Companies argue that this case is similar to *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) and *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1977). In *West Lynn Creamery*, the Supreme Court reviewed a Massachusetts statute that imposed a tax on all milk sold by dealers to Massachusetts retailers. 512 U.S. at 188. The tax collected was then distributed as a subsidy to Massachusetts dairy farmers. *Id.* The Supreme Court found that the statute's "avowed purpose and its undisputed effect are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States ... Although the tax also applies to milk produced in Massachusetts, its effect on Massachusetts producers is entirely (indeed more than) offset by the subsidy provided exclusively to Massachusetts dairy farmers." *Id.* at 194. Thus,

the Court found, "[l]ike an ordinary tariff, the tax is ... effectively imposed only on out-of-state products." *Id.* Accordingly, the Court found the statute unconstitutional because, "the purpose and effect of the pricing order are to divert market share to Massachusetts dairy farmers. This diversion necessarily injures the dairy farmers in neighboring States." *Id.* at 203.

In *Hunt*, the Court reviewed a North Carolina statute that prohibited closed containers of apples shipped into the State from bearing any grade other than the U.S. grade. 432 U.S. at 335. Washington State, the nation's largest apple producer, had developed its own grading system for apples that was equivalent to or superior to the U.S. grading system. *Id.* at 336. The Washington State Apple Advertising Commission argued that the North Carolina statute prohibiting the display of Washington State apple grades discriminated against interstate commerce. *Id.* at 335.

The Supreme Court determined that the challenged statute had the practical effect of not only burdening interstate sales of Washington apples but also discriminating against them. *Id.* at 350. First, it found that the statute forced Washington apple growers to alter their marketing practices in order to comply with the statute, unlike their North Carolina competitors. *Id.* at 351. "[T]he increased [costs of doing business] imposed by the statute would tend to shield the local apple industry from the competition of Washington apple growers and dealers...." *Id.* The Court also found the statute "has the effect of stripping away from the Washington apple industry the competitive and economic advantages it has earned for itself

through its expensive inspection and grading system." *Id.*

Finally, the Court found the statute would deprive Washington sellers of the market premium that apples sold under the superior Washington grades would otherwise command. *Id.* at 352. "Such 'downgrading' offers the North Carolina apple industry the very sort of protection against competing out-of-state products that the Commerce Clause was designed to prohibit." *Id.*

1) Statute does not Discriminate on the Basis of Geographic Location.

The entire premise of the Satellite Company's Complaint is that Kentucky's new tax provision benefits an alleged local interest, the Cable Companies, and burdens an alleged out-of-state interest, the Satellite Company. However, there is no evidence in the record regarding the principal places of business, states of incorporation or the states in which the Satellite Companies and the Cable Companies engage in economic activities. Nor have the Satellite Companies presented any other evidence from which the court can conclude that the Cable Companies are in-state economic interests.

The Satellite Companies assert that they are headquartered in states other than Kentucky and that they have no offices in Kentucky. The KCTA asserts that at least the four largest Cable Companies operating in Kentucky also are headquartered in states other than Kentucky. The parties assert that both the Cable Companies and the Satellite Companies have some employees in the state. Clearly, both engage in the economic

activity of selling video programming in the state.

Based on these undisputed assertions, the Cable Companies no more a "resident," "local," or "in-state" business than the Satellite Companies. Thus, regarding a statute that has different effects on the Satellite Companies and the Cable Companies, "there can be no local preference, whether by express discrimination against interstate commerce or undue burden upon it, to which the dormant Commerce Clause may apply." *General Motors v. Tracy*, 519 U.S. 278, 300 (1997).

More importantly, however, regardless of their geographic location, it is clear that the alleged statutory burden imposed on the Satellite Companies has nothing to do with their residence or the location of their economic activities. While conceding that Kentucky's new tax provisions require both the Cable Companies and the Satellite Companies to pay new Kentucky taxes, the Satellite companies complain that the Cable Companies will be relieved of local franchise fees while the Satellite Companies will still be burdened with federal satellite transmission fees.

Even if a satellite company should move it headquarters to Kentucky, incorporate in Kentucky and deliver programming only in Kentucky, it would still suffer the burden of having to pay the federal government for the right to transmit via satellite. Furthermore, a cable company headquartered and incorporated outside of Kentucky would still not be required to pay the federal government for the right to transmit via satellite. The different effects of Kentucky's new tax provisions on Satellite Companies and Cable Companies are owed not to the geographic location

of the companies, but to their different delivery mechanisms. The Satellite Companies' alleged burden of having to pay the federal government for the right to transmit via satellite and having to compete with Cable Companies who do not have such an expense and who no longer have to pay local franchise fees falls equally on in-state and out-of-state Satellite Companies.

Thus, the statute has the same effects on the Satellite Companies and the Cable Companies whether or not a particular company is a domiciliary or resident of Kentucky. Because the statute "visits its effects equally upon both interstate and local business," *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 87 (1987) (quotations and citation omitted), it cannot be said to discriminate against interstate commerce on the basis that it benefits in-state economic interests and burdens out-of-state economic interests.

The Satellite Companies' Complaint is not aimed solely at the effects of Kentucky's new tax provisions. It is aimed at the combined effects of the state statute and federal laws that impose satellite transmission fees. As no party has raised the issue, the court will not address whether a state statute may be challenged under the dormant Commerce Clause on the basis that, when its effects are combined with those of federal law, an unconstitutional burden is imposed on interstate commerce. It is clear, however, that the Satellite Companies' real complaint is with federal fees that apply to them solely because they deliver programming by satellite, not because of their geographic location or that of their competitors.

2) The Dormant Commerce Clause Protects the Interstate Market, not Particular Delivery Mechanisms.

The Supreme Court has stated that the dormant Commerce Clause protects the interstate market for a particular product, but it does not protect "the particular structure or methods of operation in a retail market." *Exxon Corporation v. Governor of Maryland*, 437 U.S. 117, 127 (1978). Nor does it protect "particular interstate firms" operating in an interstate market. *Id.* Likewise, the Supreme court has held that "the Commerce Clause is not violated when the differential tax treatment of two categories of companies 'results solely from differences between the nature of their businesses, not from the location of their activities.'" *Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance*, 505 U.S. 71, 78 (1992) (quoting *Amerada Hess Corp. v. Director, Div. of Taxation, N.J. Dept. of Treasury*, 490 U.S. 66, 78 (1989)).

In *Amerada*, the Supreme Court reviewed a New Jersey statute that denied oil producers a state tax deduction for the federal "windfall profit tax" imposed on producers of crude oil. *Id.* at 68. The plaintiff oil companies argued that the deduction denial discriminated against oil producers who market their oil in favor of independent retailers who do not produce oil. *Id.* at 78. They argued that the state had singled out a business activity—oil production—conducted only in other jurisdictions for a special tax burden. *Id.* at 77. The Supreme Court noted that the state also denied tax deductions for the federal income tax which applied to corporations across the country.

Id. at 77. Thus, the Court determined that the deduction denial did not discriminate on the basis of geographic location and "whatever disadvantage this deduction denial might impose on integrated oil companies does not constitute discrimination against interstate commerce." *Id.* at 77-78.

The Court explained that the oil producing plaintiffs "operate both in New Jersey and outside New Jersey. Similarly nonproducing retailers may operate both in New Jersey and outside the State. Whatever different effect the [deduction denial] may have on these two categories of companies results solely from differences between the nature of their businesses, not from the location of their activities." *Id.* Thus, the Court determined that the statute did not discriminate against interstate commerce. *Id.* at 79.

Here too, as explained above, the statute's different effects on the Satellite Companies and Cable Companies has nothing to do with the geographic location of their economic activities. No matter where a satellite company operates, it is going to have to pay the federal government for the right to transmit via satellite. The statute's different effect on the Cable Companies and the Satellite Companies is not due to their geographic location. The different effect is due to the manner by which they deliver programming.

In *Exxon*, the Supreme Court reviewed a Maryland statute that prohibited oil producers or refiners from operating a retail service station within the state. 437 U.S. at 119. The statute was in response to complaints about inequitable distribution of gasoline among retailers in the state during the oil shortage of the 1970s. *Id.* at 121.

The state government had determined that gasoline stations operated by producers and refiners had received preferential treatment during the shortage. The statute thus required the major oil companies such as Exxon to divest themselves of their retail service stations in the state. *Id.*

There were no local oil producers or refiners so Exxon could not claim that the statute discriminated in favor of them. *Id.* at 125. Thus, Exxon focused on the retail market and argued that the statute protected in-state independent dealers in the gas retail market from out-of-state competition. *Id.* The Court noted that there were several major interstate marketers of petroleum that owned retail gas stations in Maryland but did not produce or refine gasoline. *Id.* at 125-26. These interstate marketers, like the oil refiners, competed directly with the in-state independent dealers but they were not affected by the statute. *Id.* at 126.

The Court held that, as to these marketers, the Maryland statute created no barriers. "[I]t does not prohibit the flow of interstate goods, place added costs upon them, or distinguish between instate and out-of-state companies in the retail market. The absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce." *Id.* at 126. "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Id.*

The Court recognized that, as a result of the statute, refiners may stop selling gasoline in

Maryland and that consumers may start purchasing gasoline from independent dealers instead of company-operated gas stations. *Id.* at 127. Nevertheless, the Court stated, "interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to s t from one interstate supplier to another." *Id.* at 127. The Court also recognized that consumers could be injured by the loss of high-volume, low-priced stations operated by the refiners. Nevertheless, the Court found that these results "relate[] to the wisdom of the statute, not its burden on commerce." *Id.* at 128. The Court rejected Exxon's "underlying notion that the Commerce Clause protects the particular structure or methods of operation in a retail market," stating that the dormant Commerce Clause "protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations." *Id.* at 127-28.

In *Brown & Williamson Tobacco Corp. v. Pataki*, 320 F.3d 200 (2d Cir. 2003), the Second Circuit reviewed a New York statute that prohibited cigarette sellers from shipping cigarettes directly to New York consumers. *Id.* at 204. The district court had determined that the statute violated the dormant Commerce Clause because the only way an out-of-state seller could sell cigarettes to New York consumers was by establishing a store physically located in New York and this would be cost prohibitive for them. *Id.* at 212. Accordingly, the district court concluded that the statute effectively eliminated out-of-state direct sales retailers from the New York market by requiring face-to-face, instate retail sales only. *Id.*

The Second Circuit, however, found that, even if the only way that an out-of-state direct shipper could sell retail cigarettes to New Yorkers was to establish a brick-and-mortar outlet in New York, in-state direct shippers suffered the same burden as out-of-state direct shippers and, thus, the statute did not discriminate against out-of-state direct shippers. *Id.* Citing to *Exxon*, the court also determined that the fact that the particular plaintiff direct shippers may be priced out of the New York retail cigarette market did not establish a discriminatory effect because the fact that consumers may shift from one supplier to another does not subject interstate commerce to an impermissible burden. *Id.* at 213 (citing *Exxon*, 437 U.S. at 127-28). Citing to Exxon's holding that the Commerce Clause does not protect the particular structure or methods of operation in a retail market, the Second Circuit also determined that the New York statute, "merely prohibits one manner in which cigarettes could otherwise be sold to New York consumers, namely through direct shipments." *Id.* (citing *Exxon*, 437 U.S. at 127).

Thus, in *Amerada* and *Exxon*, the Court determined that the dormant Commerce Clause prohibits discrimination against the interstate market for retail gasoline but not specifically against retailers in that market who are oil producers. In *Brown & Williamson*, the Second Circuit relied on *Exxon* in finding that the dormant Commerce Clause prohibits discrimination against the interstate market for retail cigarettes, but not discrimination against retailers in that market who sell cigarettes in a particular manner.

In this case, the relevant market is the

interstate market for multichannel video programming and the relevant retailers are multichannel video programming service providers including those firms that deliver programming by satellite and those firms that deliver programming by cable. *See, e.g.*, Rec. No. 1, Complaint, ¶ 22 ("The relevant product market in which satellite and cable television companies compete is the market for multi-channel video programming distribution."). In accordance with *Exxon*, the dormant Commerce Clause prohibits discrimination against the interstate market for multichannel video programming, but it does not necessarily prohibit discrimination against programmers in that market who deliver programming by satellite as opposed to cable.

The Satellite Companies argue that this case is different from *Exxon* and *Amerada* because the " 'nature' of satellite and cable distribution is inextricably linked to geography." (Rec. No. 13, Response at 2, 3, 21). Thus, the Satellite Companies appear to argue, while in *Exxon* and *Amerada*, the Supreme Court held that discrimination based upon an out-of-state actors' method of operation or the nature of its business—as opposed to its geographic location—is not prohibited under the Commerce Clause, here such discrimination would be unconstitutional. This is because a satellite company necessarily delivers programming from satellites orbiting the earth and could never deliver programming from satellites located in the state. Cable Companies, on the other hand, necessarily deliver programming by means of cables located in the state. Thus, the Satellite Companies argue, in the interstate market for multichannel video programming, discrimination

against the economic actors that deliver programming by satellite necessarily constitutes discrimination based on the programming providers' geographic location.

In reality, however, the mechanisms by which both the Cable Companies and the Satellite Companies deliver programming lie partially outside of Kentucky and partially inside the state. In arguing that their transmission mechanisms lie totally outside of Kentucky, the Satellite Companies have arbitrarily considered only the location of their orbiting satellites. Even without considering whether the Satellite Companies utilize "local receive facilities" that are located in the state as the KCTA alleges, the Satellite Companies must concede that, in transmitting programming, they rely upon a multitude of receive dishes throughout the state.

It is also false that Cable Companies utilize only transmission facilities located in the state. Again, in determining the location of the Cable Companies' delivery mechanisms, the Satellite Companies have arbitrarily looked only to the cable headend and the cables laid or strung in the state. Before the cable programming ever gets from the cable headend to the subscribers, however, it is transmitted to the headend by out-of-state satellites and microwave systems.

More importantly, however, even assuming that the Satellite Companies' entire transmission system lies outside Kentucky and the Cable Companies' entire transmission system lies inside state, the Court finds no support for the proposition that the dormant Commerce Clause prohibits discrimination against particular means

of delivering a product when those means are "inherently" out-of-state. In *Amerada*, the issue was whether the New Jersey tax deduction denial discriminated against oil producers who are gasoline retailers in favor of local gasoline retailers who are not oil producers. 490 U.S. at 78. The Court specifically noted that the oil producers could not move their oil-producing activities to New Jersey because no oil reserves exist there. *Id.*

Thus, the oil-producing gas retailers in *Amerada* were as inherently "out-of-state" as satellite-delivering multichannel video programming providers. The Court considered this information as relevant only because it tended to show that the statute could not have been intended to induce the oil producers to move their oil-producing activities to New Jersey. Given this, the Court concluded, "it is difficult to see how [the statute] unconstitutionally discriminates against interstate commerce." *Id.* at 78; *see also id.* at 78 n.10 ("in the absence of discriminatory intent or a statute directed specifically at economic activity that occurs only in a particular location ..., a deduction denial does not unduly burden interstate commerce just because the deduction denial relates to an economic activity performed outside the taxing State.").

Exxon and *Amerada* make clear that the dormant Commerce Clause does not protect particular firms, particular methods of operation, or particular means of delivering a product. It protects interstate markets. Thus, whether the Satellite Companies' means of delivery are inherently out-of-state or not, in order to establish a violation of the dormant Commerce Clause, the

Satellite Companies must prove that the new Kentucky tax provisions discriminate against the interstate market for multichannel video programming. The Satellite Companies argue that they meet this burden simply by showing that some out-of-state actors—those delivering programming by satellite—are burdened by Kentucky's new tax provisions. *Exxon* and *Amerada* make clear that this is wrong.

3) The Statute does not Encourage Economic Activity in Kentucky or Discourage the same activity in other States.

The Satellite Companies argue that this case is similar to those in which the Supreme Court has held that a state violates the dormant Commerce Clause when it imposes "greater burdens on economic activities taking place outside the State than [are] placed on similar activities within the State." *Westinghouse Electric Corporation v. Tully*, 466 U.S. 388, 403-04 (1984).

Thus, for example, in *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977), the Supreme Court reviewed an amendment to New York's stock transfer tax that provided a reduction in the tax on nonresidents if the transaction involved a sale in New York. *Id.* at 324. The Court explained that, prior to the amendment, the New York transfer tax was neutral as to in-state and out-of-state sales. An in-state transfer or delivery of securities triggered the tax and the burden fell equally on all transactions regardless of where the sale occurred. *Id.* at 330. Thus, "the choice of an exchange for the sale of securities that would be transferred or delivered in New York was not

influenced by the transfer tax; wherever the sale was made, tax liability would arise. The flow of interstate commerce in securities was channeled neither into nor out of New York by the state tax." *Id.*

As a result of the amendments, however, if a delivery or transfer of stock occurred in New York, the seller could "substantially reduce his tax liability by selling in State." *Id.* at 331. The Court determined that "[t]he obvious effect of the tax is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges" in other states creating "both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister states." *Id.* The Court found that New York's use of its "power to tax an in-state operation as a means of 'requiring (other) business operations to be performed in the home state,'" was "wholly inconsistent with the free trade purpose of the Commerce Clause." *Id.* at 336.

In *Maryland v. Louisiana*, 451 U.S. 725 (1981), the Supreme Court reviewed a Louisiana statute that imposed a use tax on natural gas imported into in the state that had not already been taxed by another state or the federal government. *Id.* at 731. The tax owed was precisely equal to the state's severance tax imposed on Louisiana gas producers. *Id.* Since most states would have already taxed gas produced in their own state through severance taxes, the primary entities paying the Louisiana use tax would be those entities using gas produced from the federal outer continental shelf ("OCS") beneath the Gulf of Mexico and piped to processing plants in Louisiana. *Id.* at 731.

An owner paying the use tax on OCS gas received a credit on any state severance tax owed for gas produced in Louisiana. *Id.* at 756. The purpose of the tax was to equalize competition between gas produced in Louisiana and subject to the state severance tax and gas produced elsewhere that was not subject to the severance tax such as OCS gas. *Id.* at 732. The Court found that, "[o]n its face, this [severance] tax credit favors those who both own OCS gas and engage in Louisiana production." *Id.* at 756-57. The effect was to "encourage natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other states." *Id.* at 756-77.

In *Westinghouse*, the Supreme Court reviewed a New York statute that provided an income tax credit for receipts based upon a company's export products shipped from New York. 466 U.S. at 393. The Court determined that the statute had the effect of allowing a greater tax credit as a company moves more of its shipping activities into New York and decreasing the tax credit as a company increases its shipping activities in other states. *Id.* at 400. Thus, the statute both "provide[d] a positive incentive for increased business activity in New York State" and "penalize[d] increases in the [company's] shipping activities in other states." *Id.* at 400-01.

The Court determined that the statute created "an advantage for firms operating in New York by placing a discriminatory burden on commerce to its sister States.'" *Id.* at 406. (quotations and citation omitted). The Court determined that the

New York statute "violated the prohibition in *Boston Stock Exchange* against using discriminatory state taxes to burden commerce in other States in an attempt to induce business operations to be performed in the home State that could be more efficiently performed elsewhere." *Id.* (quotations and citation omitted).

In each of these cases, the Court determined that the statute's effect was to encourage economic activity in the legislating state and to discourage that same activity in other states. There is not even an allegation here that Kentucky's new tax provisions would have the effect of encouraging any economic activity in Kentucky or discouraging that same activity elsewhere. The Satellite Companies argue only that the statute will encourage Kentuckians to switch to cable programming because it will be comparatively cheaper than satellite programming.

For the reasons discuss above, however, this does not establish an unconstitutional burden on interstate commerce. Again, there is no basis from which this Court can determine that cable-delivered programming is an industry any more local to Kentucky than satellite-delivered programming. Furthermore, the statute would inflict the same burden on an in-state satellite company as on an out-of-state satellite company and the same benefit on an out-of-state cable company as an in-state cable company. Finally, the fact that a statute would burden certain out-of-state firms does not establish a violation of the dormant Commerce Clause.

Thus, this is not a case where a state is encouraging the development of a local industry by

imposing greater burdens on economic activity taking place outside the state. In fact, the Satellite Companies have put forth no explanation as to how the state of Kentucky benefits by a statute favoring cable delivery over satellite delivery.

E. Pike Balancing.

Even though the statute does not directly burden interstate commerce, the Court must nevertheless proceed to a second tier of this analysis and determine whether the statute's potential benefits outweigh the burdens that the statute places on interstate commerce. *Eastern Kentucky Resources*, 127 F.3d at 544.

"Where [a] statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). "The party challenging the statue bears the burden of proving that the burdens placed on interstate commerce outweigh the benefits that accrue to intrastate commerce." *Eastern Kentucky Resources*, 127 F.3d at 545.

The Kentucky legislature has stated that the purpose of the statute is to provide a more fair, efficient, uniform and simple method for taxing communications services in the state. Again, the Satellite Companies argue they will be burdened by a cost disadvantage relative to the Cable Companies and that Kentuckians may switch from satellite-delivered programming to cable-delivered programming. Because the Satellite Companies

have not offered any evidence that the statute will have any effect on interstate commerce, the Court cannot find that the statute imposes a burden on such commerce that is clearly excessive to the putative local benefits.

III. CONCLUSION.

For all the above reasons, the Court hereby ORDERS that the Commissioner's Motion to Dismiss (Rec. No. 10) is GRANTED and this matter is STRICKEN from the active docket of this Court.

This 30th day of March, 2006.

SEAL: United States District Court
Eastern District of Kentucky

Signed by: Karen K. Caldwell/KKC
United States District Judge

No. 06-5523

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

DIRECTV, INC. ET AL. Plaintiffs-Appellants, v. MARK TREESH, COMMISSIONER FOR THE DEPARTMENT OF REVENUE FOR THE STATE OF KENTUCKY, Defendant-Appellee.	FILED SEP 18, 2007 LEONARD GREEN, Clerk ORDER

Before: BOGGS, Chief Judge; and MERRITT and MOORE, Circuit Judges.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT
s/[illegible]
LEONARD GREEN, Clerk/[initials]

RELEVANT STATUTES

Kentucky Revised Statutes §§ 136.602, 136.604, 136.616, 136.648, 136.650, 136.652, and 136.660 provide, in relevant part:

136.602. Definitions for KRS 136.600 to 136.660.

As used in KRS 136.600 to 136.660:

* * *

(8) "Multichannel video programming service" means cable service and satellite broadcast and wireless cable service;

* * *

136.604. Excise tax; multichannel video programming services; rate-sourcing rule.

(1) An excise tax is hereby imposed on the retail purchase of multichannel video programming service provided to a person whose place of primary use is in this state, regardless of where or to whom those services are billed or paid.

(2) The multichannel video programming excise tax rate shall be three percent (3%) of the sales price charged for multichannel video programming service that is billed on or after January 1, 2006.

(3) Providers shall source multichannel video programming services to the end user's place of primary use.

* * *

136.616. Imposition of tax on gross revenues; multichannel video programming services and communications services; rates; collection of tax from purchaser prohibited; exclusion for municipal utility.

(1) A tax is hereby imposed on the gross revenues received by all providers.

(2) The tax rate shall be:

(a) Two and four-tenths percent (2.4%) of the gross revenues received for the provision of multichannel video programming service provided to a person whose place of primary use is in this state, billed on or after January 1, 2006; and

(b) One and three-tenths percent (1.3%) of the gross revenues received for the provision of communications services, as sourced under the provisions of KRS 136.605, billed on or after January 1, 2006.

(3) The provider shall not collect the tax directly from the purchaser or separately state the tax on the bill to the purchaser.

(4) (a) The tax imposed by this section shall apply to all providers except a municipal utility. "Municipal utility" as used in this section means a utility owned, operated, and controlled directly or indirectly by a city of the first, second, third, fourth, fifth, or sixth class.

(b) To the extent that the provisions of KRS Chapter 279 are inconsistent with KRS 136.600 to 136.660, KRS 136.600 to 136.660 shall control.

* * *

136.648. Gross revenues and excise tax fund and state baseline and local growth fund; creation and administration of funds.

(1) There is established in the State Treasury a gross revenues and excise tax fund. The fund shall be held and administered by the Finance and Administration Cabinet. The cabinet shall invest money in the fund in the same manner as money in the state general fund.

(2) There is established in the State Treasury a state baseline and local growth fund. The fund shall be held and administered by the Finance and Administration Cabinet. The cabinet shall invest money in the fund in the same manner as money in the state general fund.

(3) All revenue from the tax imposed under KRS 136.604 and 136.616, including all penalties and interest attributable to the nonpayment of the tax or for noncompliance with KRS 132.825 and 136.600 to 136.660 shall be deposited into gross revenues and excise tax fund. Amounts deposited in the gross revenues and excise tax fund shall be allocated among the state, political subdivisions, school districts and special districts as provided in KRS 136.648, 136.650, 136.652, 136.654, and 136.656.

(4) All money in the gross revenues and excise tax fund designated for distribution to political subdivisions under KRS 136.648, 136.650, 136.652, 136.654, and 136.656:

(a) Shall not be withheld or reduced by the General Assembly or any state agency for any reason, except for adjustments provided for within KRS 132.825 and 136.600 to 136.660; and

(b) Shall be used solely and exclusively for the provision of services to the general public, including public protection, health services, education, libraries, transportation services, and economic development. No amount shall be used for purely local purposes affecting only the inhabitants of the particular political subdivision, such as the administration of local government. Neither the General Assembly nor any state agency shall mandate how the funds are to be used.

* * *

136.650. Required participation in funds; computation of amounts; designated monthly hold harmless amount.

(1) (a) Every political subdivision, school district, and special district shall participate in the gross revenues and excise tax fund and the state baseline and local growth fund.

(b) On or before December 1, 2005, each political subdivision shall certify to the department on a prescribed form the amount of collections it received from the local franchise fees collected from communications service and multichannel video programming service providers and other fees collected to fund public educational and government access programming during the period between July 1, 2004, and June 30, 2005. By certifying its participation under this subsection, each political subdivision:

1. Consents to the hearing process provided in KRS 136.658; and

2. Agrees to relinquish its right to enforce the portion of any contract or agreement that requires the payment of a franchise fee or tax on

communications services and multichannel video programming services, regardless of whether the tax or fee is imposed on the provider or its customers.

(c) The amount of collections received by each political subdivision, school district, special district, and sheriff's department between July 1, 2004, and June 30, 2005, from the tax imposed by KRS 136.120 attributable to the franchise portion of the operating property, as noted in KRS 136.115, shall be calculated by the department from assessment data for calendar year 2004.

(2) The monthly portion of the gross revenues and excise tax fund that shall be distributed to political subdivisions, school districts and special districts under KRS 136.652 shall be computed as follows:

(a) Each political subdivision, school district and special district shall be assigned a percentage based on the amount of its collections certified under subsection (1) of this section as a ratio of the total certified amount of collections of all parties participating in the fund. This percentage shall be known as the "local historical percentage." The portion of the sheriff departments' certified collections identified in subsection (1) of this section from the tax imposed under KRS 136.120 attributable to the franchise portion of the operating property, as noted in KRS 136.115, that was imposed by county governments shall be added to each county's reported collections to determine its local historical percentage;

(b) The sheriff departments' collections certified under subsection (1) of this section that

are retained by the sheriff departments as their fee for collecting the taxes shall be the sheriff departments' fixed hold-harmless amount;

(c) Three million thirty-four thousand dollars ($3,034,000), which represents one-twelfth (1/12) of the total potential collections, shall be designated as the "monthly hold-harmless amount"; and

(d) Each political subdivision's, school district's, and special district's local historical percentage shall be multiplied by the monthly hold-harmless amount to determine its monthly distribution from the fund.

(3) If during the period between June 30, 2005, and December 31, 2005, any political subdivision had a substantial change in its base revenue by enacting or modifying the rate of a local franchise fee prior to June 30, 2005, the political subdivision may request the department to determine its certified collection amount.

(4) If any political subdivision, school district, special district, or sheriff's department believes that the data used to determine its certified amount of collections are inaccurate, the political subdivision, school district, special district, or sheriff's department may request a redetermination by the oversight committee established by KRS 136.658. A redetermination shall be effective prospectively beginning with the next distribution cycle occurring ninety (90) days after the matter is finally settled.

* * *

136.652. Distribution; administrative costs; monthly hold harmless amounts.

Money in the gross revenues and excise tax fund shall be distributed monthly as follows:

(1) One percent (1%) shall be deposited in a trust and agency account created in the State Treasury to be used by the department for administration costs associated with the implementation, collection, and distribution of the tax imposed by KRS 136.604 and 136.616.

(2) After the distribution required under subsection (1) of this section, the department shall distribute to each political subdivision, school district and special district the applicable monthly hold-harmless amount as calculated under KRS 136.650. In addition, the department shall distribute one-twelfth (1/12) of the sheriff department's fixed hold-harmless amount as defined in KRS 136.650(2)(b). For tax collections received in January and February of 2006, the department shall make the distribution by April 25, 2006. For all other periods, the department shall make distribution by the twenty-fifth day of the next calendar month following the tax receipts.

(3) After the distribution required by subsection (2) of this section, the department shall deposit one million two hundred fifty thousand dollars ($1,250,000) in the state general fund. This amount shall be adjusted on a prospective basis after the collection of the first twelve (12) months of tax receipts from the taxes imposed by KRS 136.604 and 136.616 to equal the average monthly tax receipts attributable to the taxation of satellite broadcast and wireless cable services

under KRS 136.604 and 136.616. The amount shall then become the fixed amount distributed to the general fund.

(4) Money remaining in the gross revenues and excise tax fund after the distribution required by subsection (3) of this section shall be transferred to the state baseline and local growth fund established in KRS 136.648.

* * *

136.660. Prohibitions; local franchise fee or tax defined.

(1) Except as provided in subsection (3) of this section, to the extent legally permissible, every political subdivision of this state shall be prohibited from the following:

(a) Levying any franchise fee or tax on multichannel video programming service or communications service, or collecting any franchise fee or tax from providers or purchasers of multichannel video programming service or communications service;

(b) Requiring any provider to enter into or extend the term of any provision of a franchise or other agreement that requires the payment of a franchise fee or tax; or

(c) Enforcing any provision of any ordinance or agreement to the extent that the provision obligates a provider to pay to the political subdivision a franchise fee or tax.

(2) For purposes of this section, "franchise fee or tax" means:

(a) Any tax, charge, or fee, that is required

by ordinance or agreement to be paid to a political subdivision by or through a provider, in its capacity as a provider, regardless of whether the tax, charge, or fee, is:

1. Designated as a franchise fee, sales tax, excise tax, user fee, occupancy fee, subscriber charge, license fee, or otherwise;

2. Measured by the amounts charged for services, the type or amount of equipment or facilities deployed, or otherwise;

3. Intended as compensation for the use of public or private rights-of-way, the right to conduct business, or otherwise; or

4. Permitted or required to be separately stated on the purchaser's bill; or

(b) Any in-kind payment of property or services that is required to be furnished by a provider by any ordinance that is enacted or agreement that is entered into after January 1, 2006.

* * *

(4) Notwithstanding any provision of law to the contrary, if a political subdivision imposes or otherwise attempts to require the payment of a franchise fee or tax, the political subdivision shall not receive any share of the proceeds of the tax levied by KRS 136.604 or 136.616 for the period that the imposition or attempt occurs.

(5) To the extent that a provider actually pays a franchise fee or tax with respect to multichannel video programming service or communications service that is also subject to the taxes imposed by KRS 136.604 or 136.616, the provider shall be

entitled to a credit against the amount payable to the department under KRS 136.604 and 136.616 in the amount of the franchise fee or tax, up to the amount of the total tax due with respect to the multichannel video programming service and communications service provided in that political subdivision, school district, or special district.

* * *

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In The

Supreme Court of the United States

DIRECTV, INC. AND ECHOSTAR SATELLITE, L.L.C.,

Petitioners,

v.

MARK TREESH, COMMISSIONER FOR THE DEPARTMENT OF REVENUE OF THE COMMONWEALTH OF KENTUCKY,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

A tax law enacted by Kentucky in 2005 now imposes gross revenue and excise taxes upon multichannel video programming service provided by or purchased from, *inter alia*, cable television service providers and satellite television service providers. The service is taxed at the same rate, regardless of the origin or location of the provider, the origin or situs of the service, or the amount of business done by the provider in or outside Kentucky. Kentucky's law also prohibits local taxing jurisdictions from imposing franchise or license taxes or fees upon this service and allows a credit against the gross revenue and excise taxes if these taxes or fees are levied in the face of this prohibition. This prohibition or credit protects all providers, regardless of the origin or location of the provider, the origin or situs of the service, or the amount of business done in or outside Kentucky. There is no constitutional or other legal requirement that these franchise or license fees or taxes be imposed. Cable television service providers were potentially subject to franchise or license taxes or fees under Kentucky law; § 602 of the Telecommunications Act of 1996 exempts satellite television service providers from such taxes or fees, but it does allow local jurisdictions or political subdivisions to receive revenue produced by a tax like Kentucky's.

The question presented is whether Kentucky's law in its practical operation discriminates against interstate commerce in violation of the dormant Commerce Clause.

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STATEMENT

1. In 2005, the Kentucky General Assembly enacted new excise and gross revenue taxes, effective January 1, 2006. 2005 Ky. Acts, ch. 168, §§ 90, 96, 168. These excise and gross revenues taxes are part of a "tax and distribution system" that the General Assembly found:

> (1) Addresses an important state interest in providing a fair, efficient and uniform method for taxing communications services sold in this Commonwealth;
>
> (2) Overcomes limitations placed upon the taxation of communications service by federal legislation that has resulted in inequities and unfairness among providers and consumers of similar services in the Commonwealth;
>
> (3) Simplifies an existing system that includes a myriad of levies, fees and rates imposed at all levels of government making it easier for communications providers to understand and comply with the provisions of the law;
>
> (4) Provides enough flexibility to address future changes brought about by industry deregulation, convergence of service offerings, and continued technological advances in communications; and
>
> (5) Enhances administrative efficiency for communications service providers, the

> state, and local governments by drastically reducing the number of returns that must be filed and processed on an annual basis.

Ky. Rev. Stat. Ann. ("KRS") § 136.600.

The excise tax is "imposed on the retail purchase of multichannel video programming service provided to a person whose place of primary use is in this state" at a rate of 3% "of the sales price charged." KRS § 136.604(1) and (2). The gross revenues tax is imposed on the gross revenues realized from the provision of multichannel video programming service in Kentucky. KRS §§ 136.616(1) and 136.602(12). The tax rate is 2.4% of the gross revenues. KRS § 136.616(2)(a). The term "multichannel video programming service" as used in these statutory provisions "means cable service and satellite broadcast and wireless cable service." KRS § 136.602(1), (8) and (18).

Nowhere in the 2005 legislation is any difference in treatment accorded cable service and satellite broadcast and wireless cable service based upon the location of the provider or the origin or situs of the service. Moreover, the statutory definitions of "gross revenues" and "sale price," which comprise the base of the taxes in question, make no distinction between cable service providers and satellite broadcast and wireless cable service providers, nor do they make any differentiation based upon the location of the

provider or the origin or situs of the service. KRS §§ 136.614; 136.616; 136.602(6), (12) and (17).

As KRS § 136.600 reflects, the 2005 legislation establishes a system for the distribution of the revenues generated by the excise and gross revenues taxes. KRS §§ 136.648 to 136.660. Specifically, the revenues from these taxes are to be deposited in a gross revenues and excise tax fund and allocated "among the state, political subdivisions, school districts and special districts" in accordance with the provisions of the 2005 legislation. KRS § 136.648(3).

To effectuate the purposes of this tax distribution system and this legislation generally, KRS § 136.660(1) prohibits Kentucky political subdivisions from levying, enforcing, or requiring the payment of any franchise fee or tax on multichannel video programming service. "Franchise fee or tax" is defined as:

> (a) Any tax, charge, or fee, that is required by ordinance or agreement to be paid to a political subdivision by or through a provider, in its capacity as a provider, regardless of whether the tax, charge, or fee, is:
>
> 1. Designated as a franchise fee, sales tax, excise tax, user fee, occupancy fee, subscriber charge, license fee, or otherwise;
>
> 2. Measured by the amounts charged for services, the type or amount of

equipment or facilities deployed, or otherwise;

3. Intended as compensation for the use of public or private rights-of-way, the right to conduct business, or otherwise; or

4. Permitted or required to be separately stated on the purchaser's bill; or

(b) Any in-kind payment of property or services that is required to be furnished by a provider by any ordinance that is enacted or agreement that is entered into after January 1, 2006.

KRS § 136.660(2). Any political subdivision imposing or attempting to impose a franchise fee or tax in violation of this prohibition cannot share in the proceeds of the excise and gross revenues taxes. KRS § 136.660(4). Moreover, providers receive credit against their excise and gross revenue tax liabilities for any franchise fees or taxes they actually pay, up to the total tax due for the provision or purchase of the multichannel video programming service within the political subdivision exacting the franchise fee or tax. KRS § 136.660(5).

2. For the source of the subsidy of their impermissible tax and subsidy theory, the Petitioners focus exclusively upon franchise fees cable television providers *may* be subject to when utilizing public ways and streets. *See, e.g., City of Florence v. Owen Elec.*

Cooperative, Inc., 832 S.W.2d 876, 879 (Ky. 1992). Such "[a] franchise inheres in the sovereignty of the state." *Id.* There is no requirement that such a franchise be awarded or that it be awarded to the highest and best bidder. Ky. Const. § 164 ("Before granting such franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefore publicly, and award the same to the highest and best bidder, but it shall have the right to reject any or all bids."). The Kentucky courts have also held that a person engaged in an activity otherwise subject to the franchise provisions of Kentucky law, but who had not obtained such a franchise, could be subjected to a license tax that is described below. *Hardin County Kentucky Telephone Co. v. City of Elizabethtown*, 227 Ky. 778, 14 S.W.2d 162 (1929); *Cumberland Telephone & Telegraph Co. v. City of Calhoun*, 151 Ky. 241, 151 S.W. 659 (1912).

The Petitioners suggest that federal law requires or causes local governments to charge franchise fees that are 5% of the cable television provider's gross revenues. Pet. at 4. In reality, the law states a "cable operator *may* be required under the terms of any franchise to pay a franchise fee" and that "[f]or any twelve-month period, the franchise fees paid by a cable operator with respect to any cable system *shall not exceed* 5 percent of such cable operator's gross revenues derived in such period from the operation of the cable system to provide cable services." 47 U.S.C. § 542(a) and (b) (emphasis added). Thus, there is no federal requirement that these fees be imposed. *See,*

e.g., Chicago v. Comcast Cable Holdings, L.L.C., 384 F.3d 901, 905 (7th Cir. 2004) (holding that "Section 542(a) does not purport to override state law, let alone to deny states all power in the field" and that "[s]o if, for example, Illinois law capped fees at 3%, Chicago could not rely on § 542(a) to charge 5%.").

As indicated above, Kentucky law allows the imposition and collection by "counties, towns, cities and other municipal corporations" of license fees or taxes "on franchises, trades, occupations and professions." Ky. Const. § 181. These licenses fees or taxes can be required of a variety of businesses for the right to exercise the privilege of doing business in that jurisdiction and those license taxes may be based upon the net profits or gross receipts of the taxed persons or entities. *See, e.g., Patrick v. City of Frankfort*, 539 S.W.2d 275 (Ky. 1976); *City of Louisville v. Sebree*, 308 Ky. 420, 214 S.W.2d 248 (1948); *Paducah Automotive Trades Ass'n v. City of Paducah*, 307 Ky. 524, 211 S.W.2d 660 (1948); *City of Louisville v. Sagalowski*, 136 Ky. 324, 124 S.W. 339 (1910).

Thus, the imposition of the franchise fees the Petitioners claim were the expense "subsidized" by Kentucky's new 2005 law was not inevitable or required by law. Moreover, the Petitioners were themselves subject to essentially the same type of exaction under Kentucky law – i.e., license fees or taxes – if they engaged in business in any of the various Kentucky local jurisdictions.

The Petitioners were not subject to these license fees or taxes, however, by virtue of the Telecommunications Act of 1996, which provides:

> (a) PREEMPTION – A provider of direct-to-home satellite service shall be exempt from the collection or remittance, or both, of any tax or fee imposed by any local taxing jurisdiction on direct-to-home satellite service.
>
> * * *
>
> (b) Definitions, For the purposes of this section
>
> * * *
>
> (3) LOCAL TAXING JURISDICTION – The term 'local taxing jurisdiction' means any municipality, city, county, township, parish, transportation district, or assessment jurisdiction, or any other local jurisdiction in the territorial jurisdiction of the United States with the authority to impose a tax or fee, but does not include a State.
>
> * * *
>
> (5) TAX OR FEE – The terms 'tax' and 'fee' mean any local sales tax, local use tax, local intangible tax, local income tax, business license tax, utility tax, privilege tax, gross receipts tax, excise tax, franchise fees, local telecommunications tax, or any other tax, license, or fee that is imposed for the privilege of doing business, regulating or raising revenue for a local taxing jurisdiction.
>
> * * *

> (c) PRESERVATION OF STATE AUTHORITY – The section shall not be construed to prevent taxation of a provider of direct-to-home satellite service by a State or to prevent a local taxing jurisdiction from receiving revenue derived from a tax or fee imposed and collected by a State.

Pub. L. No. 104-104, Title VI, § 602(a), 110 Stat. 144(a) (1996) (reprinted in 47 U.S.C. § 152, historical and statutory notes).

3. The Petitioners' suit challenged Ky. Rev. Stat. Ann. § 136.660(4) and (5) (or § 118 of the 2005 legislation) and sought a permanent injunction against the enforcement of these provisions. Compl. ¶ 1. They asserted that these statutory provisions had "the practical effect of discriminating against interstate commerce" because "cable system operators" paid franchise fees and satellite television providers did not, rendering these provisions "nothing but an illusory benefit to satellite providers." Compl. ¶¶ 26, 33-34.

The Petitioners' complaint stated that they then "currently provide[d] service to approximately 450,000 subscribers in Kentucky." Compl. ¶ 8. They also admitted to having sales employees located in Kentucky. Compl. ¶ 17. In addition, the Petitioners acknowledged that their "subscribers received the signal directly from satellites by means of a small, pizza-sized dish mounted on or near their house[s]" and that "[t]he signal is then transmitted to a receiver/decoder

system (a 'set-top box') connected to the television." Compl. ¶ 15.

The district court granted the Respondent's motion to dismiss for failure to state a claim upon which relief could be granted. Pet. App. at 21a, 55a. The court held that the "statutory burden imposed on the [Petitioners] has nothing to do with their residence or the location of their economic activities." Pet. App. at 40a. The court further stated that the dormant Commerce Clause "does not protect 'the particular structure or methods of operation in a retail market'" or "'particular interstate firms' operating in an interstate market." Pet. App. at 42a (quoting *Exxon Corporation v. Governor of Maryland*, 437 U.S. 117, 127 (1978)). The court also noted that "[t]here was not even an allegation that Kentucky's new tax would have the effect of encouraging any economic activity in Kentucky or discouraging that same activity elsewhere." Pet. App. at 53a. Instead, "the statute would inflict the same burden on an in-state satellite company as on an out-of-state satellite company and the same benefit on an out-of-state cable company as an in-state cable company." Pet. App. at 53a.

The Sixth Circuit unanimously affirmed the district court's decision. Pet. App. at 1a-20a. The court held that Kentucky's law had not "altered any competitive balance among in and out-of-state competitors." Pet. App. at 17a. The court noted in support of its decision that the object of the Commerce Clause was "to protect interstate commerce, and not particular firms engaged in interstate commerce, or the

mode of operation used by those firms." Pet. App. at 18a-19a.

REASONS FOR DENYING THE WRIT

The decision below is correct and does not conflict with any decision of this Court or any other court of appeals. When this case is viewed for what it is truly about, there are no special and important reasons warranting further review.

1. The focus of the facet of the dormant Commerce Clause invoked by the Petitioners is "discriminat[ion] against interstate commerce." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 277-78, 287 (1977). "A state may not 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 197 (1995) (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1957)). "[A] state may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." *Armco, Inc. v. Hardesty*, 467 U.S. 638, 642 (1984). *See also Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 332, n. 12, 336-37 (1977) (stating that "[a] tax may not discriminate on the basis of some interstate element" and that "[w]e hold only that in the process of competition no State may *discriminatorily* tax the products manufactured or the business operations performed

in any other State" (emphasis added)). "The paradigmatic example of a law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994).

Kentucky's law does not discriminate in any manner against interstate commerce. The excise and gross revenue taxes in question are imposed upon, or required to be collected by, all purchases of, or providers rendering, multichannel video programming service in Kentucky. KRS §§ 136.604; 136.616; 136.602(8), (10) and (12). No distinction of any kind is made between in-state providers and out-of-state providers or the origins of the video programming sold or provided.

The Petitioners alleged below that they "currently provide service to approximately 450,000 subscribers in Kentucky." Compl. ¶ 8. Let us assume that a new satellite company was incorporated in Kentucky and promptly commenced competition with the Petitioners, luring away half of their 450,000 subscribers. Let us further assume that the new company's headquarters and all of its facilities and employees were located or operated in Kentucky. Under this example, there would be no difference whatsoever in the treatment afforded this new Kentucky satellite television provider under the excise and revenue tax law from that accorded the Petitioners.

The Kentucky law therefore does not discriminate against interstate commerce. "When the account is made up, the stranger from afar is subject to no greater burdens . . . than the dweller within the gates." *Henneford v. Silas Mason Co.*, 300 U.S. 577, 584 (1937). Kentucky's law taxes the provision or purchase of multichannel video programming service in an evenhanded manner, regardless of the origin of the service or its provider.

Unlike other laws that have been held to offend the dormant Commerce Clause, Kentucky's law does not encourage economic activity in Kentucky or discourage the same activity in another state. Nor does it encourage consumers to deal with in-state companies at the expense of out-of-state companies. *Compare Fulton Corp. v. Faulkner*, 516 U.S. 325, 333-34 (1996); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271-73 (1984); *Boston Stock Exchange*, 429 U.S. at 607-08. Instead, Kentucky's law does not discriminate on the basis of geographic location or "exert a pressure on an interstate business to conduct more of its activities in" the state, but provides for taxation in a uniform manner that does not discriminate against interstate commerce. *Amerada Hess Corp. v. Director, Division of Taxation, New Jersey Dept. of the Treasury*, 490 U.S. 66, 77-78 (1989). *See also Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 471-72 (1980) (holding that a Minnesota law did "not effect 'simple protectionism' [in violation of the Commerce Clause], but 'regulate[d] evenhandedly' by prohibiting all milk retailers from selling their

products in plastic, nonreturnable milk containers, without regard to whether the milk, the containers, or the sellers are from outside the State."); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 619 (1981) (holding that discrimination against interstate commerce was not present because the "tax burden [was] borne according to the amount consumed and not according to any distinction between in-state and out-of-state consumers."); *CTS Corporation v. Dynamics Corporation of America*, 481 U.S. 69, 87-88 (1987) ("Because nothing in the Indiana Act imposes a greater burden on out-of-state [tender] offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce."); *Dunbar-Stanley Studios, Inc. v. Alabama*, 393 U.S. 537, 542 (1969) ("Nor is the tax invalid as a discrimination against interstate commerce [because] Alabama's tax is levied equally upon all transient or traveling photographers whether their travel is interstate or entirely within the State.").

Therefore, the decision below does not conflict with and, indeed, is entirely consistent with a number of this Court's past precedents. No further review is necessary and there is certainly no compelling reason for this Court's review, as the decision below is supported by settled principles as established by numerous decisions of this Court.

2. The Petitioners rely heavily upon what they portray as the threatened demise of *West Lynn Creamery* presented by this case. Pet. at 2-3. Their

argument overlooks the important point made in this Court's dormant Commerce Clause jurisprudence that "the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case." *Boston Stock Exchange*, 429 U.S. at 329. This case is markedly different from *West Lynn Creamery*.

The Court in *West Lynn Creamery* found the milk pricing order at issue to be in effect a "protective tariff or customs duty, which taxes goods imported from other states, but does not tax similar products produced in State." 512 U.S. at 193. This type of exaction, the Court noted, was "[t]he paradigmatic example of a law discriminating against interstate commerce." *Id.* The pricing order imposed an assessment upon all fluid milk sold by dealers to Massachusetts retailers. *Id.* at 188. The fund thereby created was distributed to Massachusetts milk producers. *Id.* at 190-91. This Court found this scheme to be "effectively a tax which makes milk produced out of State more expensive" and "[l]ike an ordinary tariff, the tax is thus effectively imposed only on out-of-state products." *Id.* at 195. This pricing order "thus [would] almost certainly 'cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market.'" *Id.* at 196. The Court accordingly held that "[t]his effect renders the [pricing order] program unconstitutional, because it, like a tariff, 'neutralizes advantages belonging to the place of origin.'" *Id.*

A linchpin of the Petitioners' case is that they are interstate and that cable television providers are local or intrastate. This contention was rightly rejected as fallacious by the courts below. Kentucky's law taxes the purchase or provision of all multichannel video programming service in Kentucky, without regard to the location of the provider or the origin or situs of the service. KRS §§ 136.614; 136.616; 136.602(6), (12) and (17). As the district court below determined, Kentucky's law "has the same effects on the Satellite Companies and the Cable Companies whether or not a particular company is a domiciliary or resident of Kentucky." Pet. App. at 41a.

Moreover, a decision of this Court establishes that cable television service is interstate and not simply local. In affirming the Federal Communications Commission's exercise of jurisdiction over such services, this Court stated:

> Nor can we doubt that CATV systems are engaged in interstate communication, even where, as here, the intercepted signals emanate from stations located within the same State in which the CATV system operates. We may take notice that television broadcasting consists in very large part of programming devised for, and distributed to, national audiences; respondents thus are ordinarily employed in the simultaneous retransmission of communications that have very often originated in other States. The stream of communication is essentially uninterrupted and properly indivisible. To

> categorize respondents' activities as intrastate would disregard the character of the television industry, and serve merely to prevent the national regulation that 'is not only appropriate but essential to the efficient use of radio facilities.'

United States v. Southwestern Cable Co., 392 U.S. 157, 168-69 (1968).

Further, it was pointed out in the proceedings below "that the three largest cable companies in Kentucky are headquartered in states other than Kentucky." Pet. App. at 24a. The Petitioners have at no time disputed this. The district court also made the following determinations:

> In reality, however, the mechanisms by which both the Cable Companies and the Satellite Companies deliver programming lie partially outside of Kentucky and partially inside the state. In arguing that their transmission mechanisms lie totally outside of Kentucky, the Satellite Companies have arbitrarily considered only the location of their orbiting satellites. Even without considering whether the Satellite Companies utilize "local receive facilities" that are located in the state as the KCTA alleges, the Satellite Companies must concede that, in transmitting programming, they rely upon a multitude of receive dishes throughout the state.
>
> It is also false that Cable Companies utilize only transmission facilities located in the state. Again, in determining the location

> of the Cable Companies' delivery mechanisms, the Satellite Companies have arbitrarily looked only to the cable headend and the cables laid or strung in the state. Before the cable programming ever gets from the cable headend to the subscribers, however, it is transmitted to the headend by out-of-state satellites and microwave systems.

Pet. App. at 48a. Here again, the Petitioners have not and cannot dispute the foregoing.

It is therefore abundantly clear that cable television service providers are not simply intrastate, instate or local businesses or economic interests. Thus, the central premise of the Petitioners' case is fundamentally flawed.

As the courts below held, the Petitioners' real complaint is that by the nature of their means of delivery of multichannel video programming service, they are not receiving the same benefit as cable television service providers. As we shall see, this point is itself subject to some debate. Nevertheless, this complaint does not implicate the dormant Commerce Clause's prohibition of discrimination against interstate commerce. As this Court has held on a number of occasions, which the courts below followed in this case, Pet. App. at 16a-19a, 42a-50a, "the Commerce Clause is not violated when the differential tax treatment of two categories of companies 'results solely from differences between the nature of their businesses, not from the location of their activities.'" *Kraft General Foods, Inc. v. Iowa Dept. of*

Revenue and Finance, 505 U.S. 71, 78 (1992) (quoting *Amerada Hess Corp.*, 490 U.S. at 78); *see also Commonwealth Edison Co.*, 453 U.S. at 617-19. The Commerce Clause "protects the interstate market," but it does not "protect[] the particular structure or methods of operation in a retail market." *Exxon Corp.*, 437 U.S. at 127-28.

The Petitioners' argument is squarely at odds with these settled principles. In their view, they will *always* be the out-of-state or interstate firm; everyone else will always be local or intrastate. As the courts below correctly held, their claim is really a plea for protection of their business or method of operation and not the interstate market.

Properly viewed, this case entailed the application of settled principles of law in a particular narrow context. Again, this case presents no compelling reasons for this Court's review.

3. The *West Lynn Creamery* case involved the creation of a fund from which subsidies were distributed to in-state dairy farmers. In this case, there are no subsidies being paid to in-state businesses. Instead, Kentucky is forbearing from the imposition of local taxes upon multichannel video programming service. Whether such taxes may or may not be imposed is a matter of state sovereignty, for the Commerce Clause "does not . . . eclipse the reserved 'power of the States to tax for the support of their own governments.'" *Boston Stock Exchange*, 429 U.S. at 328-29. Thus, Kentucky was not bound to adhere

to the system of taxation in place before the 2005 law, which is effectively what the Petitioners advocate.

As the Sixth Circuit aptly observed, "States and local government are under no mandate to charge for the use of local rights-of-way; this is readily apparent from the fact that not every road is a toll road." Pet. App. at 14a. As we have seen, there is no legal requirement that cable television service providers pay franchise fees to local governments. Likewise, there is no legal requirement that local governments impose license fees or taxes upon other persons doing business in their jurisdictions. The Commerce Clause does not demand that States structure their tax systems in any particular manner. Instead, its concern is with discrimination against interstate commerce. *Boston Stock Exchange*, 429 U.S. at 336-37.

In this case, Kentucky's law provides a nondiscriminatory prohibition against the imposition of local taxes on multichannel video programming services. This prohibition is not based upon the location of the provider or the origin or situs of the service. Kentucky political subdivisions are barred from levying these taxes or fees upon this service, regardless of its provider's location, the service's origin or situs or the amount of business done by that provider in Kentucky or elsewhere.

Moreover, the franchise fees covered by this prohibition are broadly defined. Not only does the statutory definition of the proscribed franchise fees include franchise fees in the narrow sense that the

Petitioners have focused upon, but it also embraces license fees or taxes that the Petitioners would be subject to under Kentucky law for engaging in business in the various local jurisdictions. KRS § 136.660(2); Ky. Const. § 181; *City of Louisville v. Sebree*, 214 S.W.2d at 251-52; *Paducah Automotive Trades Ass'n*, 211 S.W.2d at 661-62, 664-66. The Petitioners are, of course, exempt from these license fees or taxes by virtue of § 602 of the Telecommunications Act of 1996. But that does not make the protection of Kentucky's law any less real. At this point, that protection is perhaps redundant, but § 602 is not a binding promise and does not create any vested right for the Petitioners. *United States v. Carlton*, 512 U.S. 26, 33 (1994). Congress can repeal it at any time and then the reality of the benefit of Kentucky's law to the Petitioners would become manifest.

The existence of § 602 certainly would not make Kentucky's law discriminatory against interstate commerce. Instead, this discrimination must inhere in the law itself. This Court has stated that the appropriate inquiry is "whether *the statute under attack*, whatever its name may be, will in *its* practical operation work discrimination against interstate commerce," *Best & Co. v. Maxwell*, 311 U.S. 454, 455-56 (1940) (emphasis added), and that "[a] state tax must be assessed in light of *its* actual effect considered *in conjunction with other provisions of the State's tax scheme*." *Maryland v. Louisiana*, 451 U.S. 725, 756 (1981) (emphasis added). As this Court stated in

Moorman Mfg. Co. v. Bair, 437 U.S. 267, 277, n. 12 (1978):

> Appellant also contends that the Iowa formula discriminates against interstate commerce in violation of the Commerce Clause and the Equal Protection Clause, because an Illinois corporation doing business in Iowa must pay tax on a greater portion of its income than a local Iowa company, and an Iowa company doing business in Illinois will pay tax on less of its income than an Illinois corporation doing business in Iowa. The simple answer, however, is that whatever disparity may have existed is not attributable to the Iowa statute. It treats both local and foreign concerns with an even hand; the alleged disparity can only be the consequence of the combined effect of the Iowa *and* Illinois statutes, and Iowa is not responsible for the latter.

(Emphasis by Court.) By the same token, Kentucky's law is not responsible for § 602 of the 1996 Telecommunications Act and cannot be in violation of the dormant Commerce Clause by virtue of that law.

If anything, § 602 represents Congressional consent to the manner of taxation Kentucky has adopted. *See Western and Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 652 (1981) ("[I]f Congress ordains that the States may freely regulate an aspect of interstate commerce, any action taken by a State within the scope of the congressional authorization is rendered invulnerable to Commerce

Clause challenge"). Under this federal law, Kentucky is specifically authorized to impose a tax upon direct-to-home satellite service and distribute the revenue so obtained to local jurisdictions and that is precisely what it has done by the 2005 law. Consequently, there can be no dormant Commerce Clause violation here. *Id.* The appropriate forum for the Petitioners' complaint that they are being subjected to unfair or burdensome state taxation is Congress, where they apparently have had some success in the past. Pet. at 20-21.

In the final analysis, the Petitioners' claim is not about discrimination against interstate commerce, but is instead about preserving an advantageous position they enjoyed under prior state law in tandem with federal law. As we have seen, however, it is settled that the Commerce Clause does not protect particular interstate businesses, yet that is precisely what the Petitioners advocate here. Their claim that the 2005 legislation provides them with only an "illusory benefit" is unfounded and is in reality a claim for the perpetuation of their historical tax advantage and not one for discrimination against interstate commerce.

4. The Petitioners have offered no compelling reasons for this Court's review. The Sixth Circuit's decision does not conflict with that of any other United States court of appeals or state court of last resort. The cases that Petitioners invoke in support of their assertion of such a conflict bear no resemblance to this case.

The Petitioners' criticism of the Court of Appeals for stating that "a purpose *might* have been to aid the cable industry rather than the satellite industry" does not establish a basis for further review. Again, as we have seen, the dormant Commerce Clause forbids discrimination against interstate commerce and does not protect particular interstate firms or methods of operation in an interstate commerce. Furthermore, the Petitioners did not allege below that Kentucky's law had a discriminatory purpose, Compl. ¶ 35, and this is reflected in their petition's statement of the QUESTION PRESENTED. Pet. at i. Moreover, they did not establish, nor did any court below find, the existence of any discriminatory purpose or motive.

None of the Petitioners' other arguments establish compelling reasons for this Court's review. The fact of the matter is that Kentucky has imposed a uniform, nondiscriminatory tax in the particular context of the taxation of multichannel video programming service. The Sixth Circuit decision is in accord with numerous past decisions of this Court. *See, e.g., Kraft General Foods*, 505 U.S. at 78; *Amerada Hess*, 490 U.S. at 75-79; *Exxon Corp.*, 437 U.S. at 125-28.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

DIRECTV, INC. and ECHOSTAR SATELLITE L.L.C.,

Petitioners,

– v. –

MARK TREESH, Commissioner for the Department of Revenue for the Commonwealth of Kentucky,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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March 17, 2008

RULE 29.6 STATEMENT

Petitioners DIRECTV, Inc. and EchoStar Satellite L.L.C. refer to their Rule 29.6 Statements in the Petition for Writ of Certiorari in this matter. DIRECTV amends that statement, to make it current, as follows: News Corporation and its wholly owned subsidiary Fox Entertainment Group have sold their ownership interest in The DIRECTV Group, Inc. to Liberty Media Company, a publicly traded company.

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INTRODUCTION

The most distinctive feature of Kentucky's Brief in Opposition is how little it opposes.

Point I of the Petition asserts that "Kentucky's tax-and-subsidy scheme raises a novel Dormant Commerce Clause issue" that this Court has not resolved. Pet. 11 (capitalization altered). Kentucky does not disagree.

Point II claims that "this case raises issues of national importance." Pet. 18 (capitalization altered). Kentucky offers not a word of opposition.

Point III opens with the assertion that "the Court of Appeals erred in" resolving the question presented, by "distinguishing between two sorts of subsidies—paying cash and covering costs." Pet. 26 (capitalization altered). Kentucky does not defend that holding. Point III then identifies two other mistakes. Pet. 31-36. Kentucky blindly repeats, scarcely defends, or reluctantly accepts all of these errors.

Instead of focusing on defending the decision below, Kentucky directs almost all its energy to a sideshow—an alternative argument in support of the outcome that was neither raised in the Petition nor resolved by the Court of Appeals. The alternative argument is so flawed that it should not dissuade this Court from taking this case to resolve the novel issues of national importance that Petitioners raise. If anything, the opportunity to reject Kentucky's main merits argument should be an added enticement, for it underscores that this Court can clarify how longstanding principles apply to a variety of important new technological markets.

ARGUMENT

I. KENTUCKY DOES NOT DISPUTE THAT THIS CASE RAISES A QUESTION THIS COURT HAS NEVER RESOLVED, AND OFFERS NO DEFENSE OF THE COURT OF APPEALS' RESOLUTION OF THAT QUESTION.

The Petition demonstrates that the lower courts are confused as to which tax devices, and combinations of devices, are impermissibly discriminatory, especially when it comes to tax-and-subsidy schemes. *See* Pet. 11-18. In particular, the Petition shows that this Court has never addressed the combination presented here, involving subsidies in the form of cost abatement, as opposed to subsidies in the form of cash payments. *See* Pet. 16-18. Kentucky does not dispute either the general point or the specific one.

If anything, Kentucky underscores the need for this Court's intervention. The brief passage in the Opposition that focuses on the central question presented tries to distinguish *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), as follows: "The *West Lynn Creamery* case involved the creation of a fund from which subsidies were distributed to in-state [businesses]. In this case, there are no subsidies being paid to in-state businesses." Opp. 18. That is exactly the point of the Petition: Kentucky is not directly paying subsidies to in-state businesses, but is instead achieving the same end by paying a cost on their behalf. The question is whether that makes a difference, as Kentucky claims, and as the Court of Appeals held. This Court has never answered that question, and Kentucky does not say that it has.

What is perhaps most striking about Kentucky's discussion of the merits of the novel question presented is that Kentucky, like the Court of Appeals, does not even try to explain why discriminatory cost abatement *should* be treated any differently than the discriminatory cash subsidy in *West Lynn Creamery*. Kentucky does not dispute that a uniform state tax implicates precisely the same considerations when tied to discriminatory cash payments as when tied to discriminatory cost abatement. *See* Pet. 26-31. Kentucky does not suggest that the two have different economic effects. *See* Pet. 27-29. Nor does Kentucky dispute that it has replicated the same political dynamic that troubled this Court in *West Lynn Creamery*. *See* Pet. 29-30.

In short, in both economic effect and political form, the form of the subsidy is indistinguishable from the one this Court struck in *West Lynn Creamery*. Kentucky disputes none of this.

II. KENTUCKY DOES NOT DISPUTE THAT THIS CASE IMPLICATES ISSUES OF PROFOUND NATIONAL IMPORTANCE.

Kentucky also does not dispute that the stakes in this case are extraordinarily high. First, Kentucky does not dispute that the Court of Appeals' analysis is a roadmap for an end-run around the Dormant Commerce Clause's prohibition against discriminatory taxes and other forms of state economic protectionism. Pet. 18-19. As the National Taxpayers Union has pointed out, "similar schemes can be implemented by any other state and can be used to discriminate in favor of in-state interests in practically any industry." NTU Br. at 20.

Second, Kentucky does not even try to rebut Petitioners' extensive argument that the impact of this case could be especially profound in the market for multi-channel video programming. Kentucky breathes not a word of dissent to Petitioners' arguments that: (1) the entry of satellite TV into the market has had a profound effect on the quality and price of multi-channel television programming; (2) states have strong economic incentives to favor local cable monopolies over satellite; or (3) the gains satellite has made are fragile and could be scuttled if states follow Kentucky's lead by effectively adding a 5% cost on satellite customers, alone. *See* Pet. 19-25; Public Knowledge Br. at 19-21.

Third, both Petitioners and *amici* have underscored the profound ramifications that the Court of Appeals' ruling can have for other industries, particularly industries harnessing new technologies with minimal footprints in any particular state. *See* Pet. 24-25; Public Knowledge Br. at 21-22.

Kentucky does not refute any of these practical consequences.

III. KENTUCKY'S ALTERNATIVE GROUND SUPPORTING THE RESULT BELOW IS MERITLESS AND WILL NOT PREVENT THIS COURT FROM ADDRESSING THE QUESTION PRESENTED.

Kentucky's main argument against certiorari is that the Court of Appeals reached the right result, on an alternative ground: that discrimination against satellite and in favor of cable is not discrimination against interstate commerce. Opp.

10-13, 15-17, 18.

Notably, the basis Kentucky offers for this conclusion is different from anything the Court of Appeals held. The Court of Appeals held that discrimination against satellite did not implicate interstate commerce because cable and satellite are two "distinct" services. App. 16a. As Petitioners have demonstrated, that holding is plainly incorrect, Pet. 31-35—so obviously incorrect that Kentucky does not even try to advance that argument.

Rather, the main thrust of Kentucky's argument is that its law does not discriminate against out-of-state businesses in some of the traditional and blatant ways that have been illegal for well over a century. Thus, for example, Kentucky correctly points out that its law does not explicitly "make any differentiation based upon the location of the provider or the origin or situs of the service," Opp. 2-3; and that "[n]o distinction ... is made between in-state providers and out-of-state providers or the origins of the video programming sold or provided," Opp. 11.

These observations prove only that the protectionist movement has learned lessons from the Nineteenth Century, when this Court invalidated simpler forms of discrimination, such as drummers' laws of the post–Civil War era that discriminated against a salesperson or personal service provider who is just traveling through a state, or import tariffs that, by definition, burden only products from other states. *See, e.g.*, *Welton v. Missouri*, 91 U.S. 275 (1876); *Nippert v. City of Richmond*, 327 U.S. 416 (1946).

But Dormant Commerce Clause jurisprudence did not freeze during Reconstruction. Over the past 30 years in particular, this Court has recognized that state protectionism undermines interstate commerce even if it does not explicitly declare, "out-of-state businesses are unwelcome here" or "out-of-staters must pay higher tariffs." As the Petition explains, a long line of cases, beginning with *Boston Stock Exchange*, stands for the proposition that the Dormant Commerce Clause is not limited to such ham-handed measures. It is every bit as impermissible for a state to favor one business over another, or one transaction over another, because that business or transaction entails more in-state activity. *See Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977) (higher tax rate for in-state residents' stock transactions completed through out-of-state exchanges); *Maryland v. Louisiana*, 451 U.S. 725, 774-75 (1981) (credit for in-state gas refining against severance tax for in-state gas production); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 400 (1984) (credit against franchise tax for increasing ratio of exports through in-state ports); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (higher intangibles tax rate for residents' ownership of stock in corporations with out-of-state income); *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564 (1997) (withheld property tax exemption for in-state accommodations servicing out-of-state residents); *see also Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (6th Cir. 2004) (income tax credit for locating machinery and equipment in state), *vacated on other grounds*, 547 U.S. 332 (2006).

As these cases recognize, the means by which

discrimination can implicate interstate commerce are as varied as the firms and their goods and services in our modern economy. The manufacture and production of goods, long specialized and mechanized, is being accomplished by ever larger accumulations of capital. The major corporations that generally undertake these activities must choose where to locate the various components of their infrastructure, from corporate offices to manufacturing facilities, and from ports of entry to diversified holdings. Similarly, the delivery of services has moved well beyond personal services and implicates complex industries as fundamental as electricity and as evolving as telecommunications and video. In many of these markets, rapid technological changes and intensive innovation have created new industries and methods of competition. These methods of competing often involve increasingly less intensive investment in infrastructure in a particular state in order to service its residents. They also make it easier for sellers of goods to reach a state's residents without making bricks-and-mortar investments in the state. This Court has been at least as concerned about state efforts to influence these decisions and developments as it has about protection of simpler forms of in-state interests.

Kentucky does not deny that the law has evolved over time and does not argue that Petitioners are misreading cases like *Boston Exchange*. Its only response to this line of cases is that "Kentucky's law does not encourage economic activity in Kentucky." Opp. 12. Kentucky made the same argument below, and the Court of Appeals did not embrace it because it was so clearly incorrect. The complaint alleges (and Kentucky

cannot dispute at this juncture) that Kentucky's new statutory structure boosted cable's competitive position in relation to its satellite competitor. Kentucky does not dispute that cable inherently involves significantly greater in-state economic activity than satellite. The end result, then, is that Kentucky's new tax structure rewards the business that entails greater local economic activity and punishes the business that entails less local economic activity. In short, Kentucky's law does, indeed, "encourage economic activity in Kentucky."

Kentucky cannot change this reality by manipulating the "in state" and "out of state" labels, pointing out, for example, that its tax laws do not depend on a company's domicile. *See* Opp. 11, 15-17. As Petitioners have demonstrated, Dormant Commerce Clause jurisprudence no longer depends on the domicile or corporate headquarters of various businesses. *Boston Stock Exchange*, for example, would undoubtedly have come out the same way had the out-of-state exchange been owned by New Yorkers. Moreover, this Court has consistently held that discrimination in favor of the in-state competitors and against the out-of-state competitors is not excused just because the discrimination is less than absolute. *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 391 (1994); *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354 n.4 (1951). Nor is Commerce Clause scrutiny defeated, for example, if a favored local electric utility happens to import its coal from another state.

Contrary to Kentucky's assertion, nothing in *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978), affects this case. The Court there held that the

Commerce Clause protects interstate markets, not the structure or methods of operating in a retail market. Opp. 18. *Exxon*, however, is nothing like this case. There, a Maryland law prohibited oil refiners from vertically integrating with gas retailers in the state. That law advanced a particular philosophy of political economy. Under that philosophy, it is better for those producing and refining oil to not have involvement in, ownership of, or control over retail gas stations. Large producers and refiners would have to negotiate contracts with an independent tier of firms within the distribution system to have the outlets necessary for their gas to reach consumers. Those selling gas to consumers would all have the same independence from refiners generally and the same need to contract with a particular refiner for a supply.

Operating in the post-*Lochner* era, this Court held that neither due process, nor antitrust laws, nor the Dormant Commerce Clause precluded Maryland from adopting this structural approach to competition, this philosophy of political economy. *Exxon*, 437 U.S. at 124-34. Maryland's vertical segregation of the distribution of gas, this Court held, was not a Dormant Commerce Clause violation just because the disadvantaged oil refiners all happened to be out-of-state. In fact, that meant that there were no favored in-state refiners. *Id.* at 125. At the producer and refiner level of distribution, there was no discrimination among firms based on the extent of their investments in or activities within the state. Thus, the net effect of the restructuring was that some businesses might "shift from one interstate supplier to another." *Id.* at 125, 127. But that shift

would not be toward a refiner that had a heavier footprint in the state or that otherwise occupied a favored position within the state.

The fact that many of the independent retailers who benefited from the segregation of refiners from retail markets were owned by state residents was equally irrelevant to this Court. There was no discrimination at the retail segment of the segregated distribution chain either. Nothing prevented out-of-state, independent retail chains from entering the state and competing with the in-state retailers who benefited from the law. *Id.* at 125-26. Simply put, particular independent retailers did not benefit to the extent that they were owned by in-state interests or otherwise favored by the state.

Here, in contrast, Kentucky has not acted in a non-discriminatory manner to advance a new philosophy of political economy that strikes at vertical integration in the production and delivery of video programming. Rather, Kentucky acted to favor one competitor over another within the same segment of the market. Its favored competitor has an inherent dependence on local investment and activity. Unlike the disadvantaged oil refiners in *Exxon*, Petitioners can point to horizontal competitors that are favored because of their in-state activities. Unlike the favored independent retailers in *Exxon*, cable distributors benefit because of their relatively heavy in-state footprint. The discrimination here, unlike the discrimination in *Exxon*, will certainly "cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market." *Id.* at 126 n.16. Nor can

it be said here that non-integrated out-of-state retailers are unaffected by the law—the satellite providers are non-integrated out-of-state retailers.

IV. KENTUCKY'S TAX LAW DISCRIMINATES IN FAVOR OF CABLE AND AGAINST SATELLITE.

Beyond offering an erroneous conception of what it means to discriminate against interstate commerce, which the Court of Appeals did not adopt, Kentucky has precious little to say in defense of the rationale the Court of Appeals did adopt.

Kentucky argues that there is no discrimination because Kentucky's law imposes the same tax rate on both cable and satellite. Opp. 11. That was true of the state law that this Court struck in *West Lynn Creamery*. But of course, this Court has long recognized that even a uniform tax can be impermissibly discriminatory if integrated with a discriminatory subsidy. Thus, this argument does not get Kentucky anywhere, unless it can demonstrate that the subsidy—the payment of franchise fees on behalf of cable—is non-discriminatory.

On this point, Kentucky responds that there is no discriminatory subsidy, because Kentucky has merely abolished cable franchise fees, which it was under "no legal requirement" to maintain. Opp. 19. The complaint, however, alleges—and Kentucky cannot at this juncture deny—that the practical effect of the Kentucky law was not to abolish the franchise fees. Pet. 7-9, 30-31.

Kentucky acknowledges that courts must look beyond formalism and assess the net practical

effect of the scheme. Pet. 20. But it does not refute any of the reasons Petitioners have recited for why this integrated scheme is not, and cannot be treated as, a simple repeal of franchise fees. First, *pace* Kentucky's portrayal of them as taxes, franchise fees are costs that cable companies pay in return for real economic benefits. Pet. 3-4, 31 & n.6. The Sixth Circuit assumed that fact, as it had to. Second, as a practical matter, Kentucky has retained franchise fees, but merely acts as the collection agent for the municipalities—so that now the state collects equivalent payments and transfers them directly to the local governments. Pet. 7-9, 30-31. Third, Kentucky neutralized any opposition from local governments by replacing the franchise fees with equivalent (or greater) revenue from the same sources. Kentucky preserved for local governments in substance exactly what it took away in name. Pet. 8-9, 30. In short, as an economic matter and a political matter, franchise fees remain in effect.

Kentucky asserts that Petitioners are simply trying to "preserv[e] an advantageous position they enjoyed under prior state law in tandem with federal law," which prohibits local governments from imposing franchise fees on cable. Opp. 22. It seems to blame the discriminatory effect on federal law. *Id.* In so arguing, however, Kentucky seems to ignore the obvious point that the reason Congress prohibited local governments from collecting franchise fees from satellite companies was that these companies do not dig up public streets or hang wires on local utility poles. The discrimination here consists of Kentucky's decision to pay on cable's behalf a cost that cable alone incurs, and that, for good reason, local

governments cannot legally impose on satellite providers. It is the Kentucky law that discriminates, and it is the Kentucky law that must be struck.

CONCLUSION

For these reasons, the Court should grant the Petition.

Respectfully submitted,

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IN THE

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DIRECTV, INC. AND ECHOSTAR SATELLITE L.L.C.,
Petitioners,

v.

MARK TREESH, Commissioner for the Department of Revenue for the Commonwealth of Kentucky,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF OF *AMICUS CURIAE* NATIONAL TAXPAYERS UNION IN SUPPORT OF PETITIONERS

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IN THE

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No. 07-1004

DIRECTV, INC. AND ECHOSTAR SATELLITE L.L.C.,
Petitioners,

v.

MARK TREESH, Commissioner for the Department of Revenue for the Commonwealth of Kentucky,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF OF *AMICUS CURIAE* NATIONAL TAXPAYERS UNION IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICUS CURIAE* [1]

The National Taxpayers Union ("NTU") was founded by concerned taxpayers in 1969. It is a nonprofit,

[1] Pursuant to Supreme Court Rule 37.6, NTU affirms that no counsel for any party authored this brief in whole or in part. No person or entity — other than NTU, its members, or its counsel — made a monetary contribution specifically for the preparation or submission of this brief. Pursuant to Supreme Court Rule 37.2(a), the NTU respectfully submits this brief *amicus curiae* in support of the petition for a writ of certiorari. All of the parties have consented in writing to the filing of this brief, and copies of the consent letters are included in the appendix to this brief.

nonpartisan membership organization devoted to protecting the interests of federal, state, and local taxpayers through public education, lobbying, and litigation on tax, spending, regulatory and economic issues. The organization has actively participated in matters involving telecommunications policy such as video franchising reform, internet access taxation, and spectrum auctioning. NTU represents over 362,000 members in all fifty states, with approximately 3,000 members in Kentucky.

A fundamental purpose of the NTU is challenging improper or illegal taxation on behalf of taxpayers who might otherwise face insurmountable hurdles in attempting to vindicate their legal and constitutional rights. NTU has litigated against efforts by state and local authorities to erode constitutional restraints on their taxing authority, including the restraints imposed by the "dormant" aspect of the Commerce Clause as defined by this Court. Representatives of NTU have also testified before congressional committees and various state legislatures about the danger to the federalism balance struck by the Constitution that arises when state and local governments exercise unrestrained taxing authority. This experience places NTU in a unique position to advise this Court about the implications of the decision by the United States Court of Appeals for the Sixth Circuit to uphold Kentucky's unconstitutional and discriminatory tax on the multichannel video programming industry.

Based on NTU's experience in the area of taxation, it believes that the Sixth Circuit's decision to uphold Kentucky's tax scheme jeopardizes the Commerce Clause's protection of interstate commerce from discriminatory taxation. Specifically, Kentucky's scheme

is a tax in name and a tariff in effect. Similar, and similarly unconstitutional, schemes have already been imposed upon the multichannel video programming industry by the states of Florida, Utah, North Carolina, Ohio, and Tennessee. By upholding Kentucky's discriminatory tax scheme, the Sixth Circuit has provided states with a roadmap for circumventing the protections of the Commerce Clause. As a result, there is a significant danger not only that other states will impose similar tax schemes to discriminate against interstate competition in the multichannel video programming industry, but also that states will follow Kentucky's lead, which has been blessed by the Sixth Circuit, to impose similar discriminatory tax schemes to provide a competitive advantage to in-state operators in other industries. NTU believes that such discriminatory taxation would be detrimental to the Constitution, to interstate commerce, and most importantly, to the taxpayers whom the Constitution protects. As a result, NTU submits this brief as *amicus curiae* in support of Petitioners.

SUMMARY OF ARGUMENT

Petitioners DIRECTV, Inc. and EchoStar Satellite, LLC ("Satellite Operators") do not exaggerate when they describe the decision of the United States Court of Appeals for the Sixth Circuit as a eulogy for the "dormant" Commerce Clause.[2] The Kentucky tax on multichannel video programming, blessed below by the Sixth Circuit, is a thinly-veiled tariff parading as

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[2] The decision below of the United States Court of Appeals for the Sixth Circuit in *DIRECTV, Inc.* v. *Treesh*, 487 F.3d 471 (6th Cir. 2007), is reproduced in the Appendix to the Satellite Operators' Petition ("Pet. App.") at pages 1a-20a.

a tax. The scheme purports to impose equal taxes on satellite and cable television service. In reality, the tax burden on cable operators is offset by companion provisions freeing cable operators from paying franchise fees to local governments and directing that the proceeds of the tax on multichannel video programming be used to reimburse local governments for the lost franchise fees. As a result, there is little if any net cost impact on cable companies. In contrast, the new taxes imposed on the cable operators' only rivals in the market — the Satellite Operators — are not offset by any similar relief. Thus, only these out-of-state service providers bear the brunt of Kentucky's tax scheme.[3] By upholding this discriminatory tax scheme, the Sixth Circuit has jeopardized the Commerce Clause's prohibition of taxes that discriminate against interstate commerce. The Sixth Circuit's goal may have been merely to avoid extending the Commerce Clause's protections beyond the bounds previously recognized by this Court, in keeping with Justice Scalia's admonishment in his concurrence in *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186, 211 (1994). However, the Sixth Circuit's decision does not preserve the status quo, but rather creates a loophole in the protection provided by the Commerce Clause wide enough to

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[3] In *Directv* v. *Treesh*, the Sixth Circuit made clear that, for purposes of its analysis, it was accepting as true the allegations in the Satellite Operators' complaint that the Satellite Operators "used no infrastructure whatsoever within the state to deliver programming," and that the cable operators, in contrast, made substantial investments in, and had a substantial presence within, the state. See *Treesh*, Pet. App. 9a. Accordingly, NTU treats the Satellite Operators as out-of-state interests and the cable operators as in-state interests for purposes of this brief.

allow states to discriminate in favor of in-state operators no less effectively than if the States were allowed to impose traditional tariffs.[4]

This Court should grant certiorari to prevent a diminution of the protections provided by the Commerce Clause to interstate commerce. This Court should also grant certiorari because the Sixth Circuit's analysis is flawed. The fundamental premise underlying the Sixth Circuit's decision — that the Kentucky tax scheme is permissible because Kentucky is using the proceeds of an industry-wide tax to replace fees owed previously by in-state operators to localities rather than exempting in-state operators from the industry-wide tax or paying a subsidy to in-state operators directly — cannot be reconciled with this Court's Commerce Clause jurisprudence.

In their petition, the Satellite Operators discuss how the Sixth Circuit's fundamental premise cannot be reconciled with *West Lynn Creamery*. NTU agrees with the Satellite Operators on this point. The Sixth Circuit's decision is contrary to this Court's repeated admonishment that state tax schemes must be evalu-

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[4] In presenting this brief, NTU recognizes that states should have discretion to use their taxing authority in a manner that promotes business, attracts industry, and reduces the tax burden on residents. This Court has repeatedly emphasized, however, that there is a line between "tax systems [that] encourage the growth and development of intrastate commerce and industry" and tax systems that discriminate by giving in-state operators an unnatural advantage over their out-of-state rivals in the same industry. See, *e.g.*, *Boston Stock Exch.* v. *State Tax Comm'n*, 429 U.S. 318, 336-337 (1997). NTU asks this Court to grant certiorari in this case because it believes that the Kentucky tax on "multichannel video programming" crosses this line to the detriment of taxpayers.

ated according to the economic realities of the scheme, and that discriminatory state taxation that has the effect of a tariff is unconstitutional regardless of whether it is "forthright or ingenious" in its construction. *West Lynn Creamery*, 512 U.S. at 201. NTU does not repeat the Satellite Operators' arguments regarding why Kentucky's tax scheme is indistinguishable from the tax-and-subsidy scheme in *West Lynn Creamery*. Instead, NTU will highlight two aspects of this case not addressed as extensively by the Satellite Operators.

First, the Sixth Circuit's analysis cannot be reconciled with the decisions of this Court prohibiting states from exempting in-state operators from industry-wide taxes. This Court has repeatedly declared such schemes unconstitutional because they are indistinguishable in effect from a traditional tariff. The Kentucky scheme operates equally as a tariff. It imposes new tax burdens on out-of-state operators while offsetting the tax burden on in-state operators by relieving them of their obligation to pay franchise fees to localities for rights of way across public lands. The net effect is that only out-of-state operators bear an additional burden as a result of the tax. The Sixth Circuit approves of Kentucky's scheme, however, because Kentucky uses the proceeds of its industry-wide tax to pay off other obligations imposed by the State's subordinate localities rather than exempting the in-state operators from paying the industry-wide tax. See *DIRECTV, Inc.* v. *Treesh*, Pet. App. 16a-17a. Indeed, it appears that under the Sixth Circuit's rationale, there is only one burden that states are prohibited from paying off with the proceeds of an industry-wide tax — the industry-wide tax itself — and states are permitted to use the proceeds of an

industry-wide tax to pay off any other burden borne by the in-state operators.

The Sixth Circuit offers no explanation for why this difference is constitutionally significant. Moreover, the Sixth Circuit runs afoul of decades of commerce clause jurisprudence from this Court by impermissibly ignoring the "economic realities" of the tax scheme. At bottom, the Sixth Circuit's decision, if allowed to stand, will undermine the Commerce Clause's protection of interstate commerce by providing states with a roadmap for enacting discriminatory tax schemes that duplicate the effects of a tariff while surviving constitutional scrutiny.

Second, the Sixth Circuit's decision ignores two aspects of the Kentucky tax scheme that this Court has recognized as hallmarks of schemes that discriminate against interstate commerce in violation of the Commerce Clause. The Kentucky tax scheme creates in-state benefits by burdening only out-of-state interests. In addition, it "mollifies" in-state interests that would otherwise be expected to oppose the tax scheme by providing them with a countervailing benefit that is not provided to out-of-state rivals. As we discuss below, this Court has held in a number of cases that when such a statute is enacted, the normal legislative protections against abusive state laws are not present and that it is the proper role of the Commerce Clause to step in and prevent abuse.

One such case is *West Lynn Creamery*, 512 U.S. at 200-201. Justice Stevens, writing for the majority, noted in *West Lynn Creamery* that the Massachusetts tax on the sale of milk there at issue had "mollified" in-state dairy producers with a subsidy that more than offset the burden of the tax on milk distribution. *Id.* The Kentucky tax on multichannel video pro-

gramming similarly mollifies in-state cable companies by eliminating franchise fees and mollifies the localities that had charged the franchise fees by providing them with the proceeds of the tax on multichannel video programming. This Court has repeatedly declared similarly discriminatory schemes unconstitutional under the "dormant" aspect of the Commerce Clause. Accordingly, this Court should grant certiorari and make clear that discriminatory state tax schemes that obtain in-state benefits by burdening only out-of-state interests and subvert the ordinary balancing of interests inherent within the legislative process by effectively bribing in-state interests to support the tax violate the Commerce Clause's prohibition of discrimination against interstate commerce.

ARGUMENT

I. THE SIXTH CIRCUIT'S DECISION UNDERMINES THE COMMERCE CLAUSE PROHIBITION OF STATE TAXES THAT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

The Sixth Circuit's interpretation of the Commerce Clause is unworkable because it provides states with the capability of using tax schemes to discriminate — practically at will — in favor of in-state operators by imposing nominally equal taxes but then giving the in-state provider an offsetting benefit. The purpose of this Court's "dormant" Commerce Clause jurisprudence has consistently been to deny states this authority. Indeed, this Court has repeatedly struck down state schemes that tax in-state and out-of-state operators in an industry equally, but then provide only in-state operators with credits or exemptions

that neutralize the detrimental effect of the statute. See, *e.g.*, *New Energy Co. of Indiana* v. *Limbach*, 486 U.S. 269 (1988); *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263 (1984); *Armco Inc.* v. *Hardesty*, 467 U.S. 638 (1984); *Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388 (1984); *Maryland* v. *Louisiana*, 451 U.S. 725 (1981).

The Sixth Circuit takes the position that the Kentucky statute is different, and therefore constitutional, because Kentucky uses the proceeds from the industry-wide tax on multichannel video programming to pay off other state imposed liabilities — franchise fees imposed by the state's subordinate localities — rather than exempting in-state cable operators from the tax on multichannel video programming. See *DIRECTV, Inc.* v. *Treesh*, Pet. App. at 15a-17a. The Sixth Circuit offers no analysis for why this difference is constitutionally significant. Nevertheless, under the Sixth Circuit's view the Commerce Clause only prohibits states from using the proceeds from an industry-wide tax to pay in-state operators' liability under the industry-wide tax itself. According to the Sixth Circuit, states are permitted to impose industry-wide taxes and set aside the proceeds of those taxes to pay-off other burdens on behalf of in-state operators, even when the payment of these burdens nullifies the entirety of the effect of the industry-wide tax on in-state operators and duplicates the effect of a traditional tariff.

This Court has repeatedly rejected the Sixth Circuit's unwarranted, form-over-substance, conception of the Commerce Clause. See, *e.g.*, *West Lynn Creamery*, 512 U.S. at 193. As this Court noted in *Maryland* v. *Louisiana*, "[i]n each case it is our duty to determine whether the statute under attack, what-

ever its name may be, will in its practical operation work discrimination against interstate commerce." 451 U.S. 725, 756 (1981).

Maryland v. *Louisiana* provides a useful example. In that case, Louisiana imposed an industry-wide tax on the "first use" of natural gas in the state, but "provided a number of exemptions from and credits" against other state-imposed taxes to abate the burden of the industry-wide tax on in-state producers and distributors of natural gas, as well as in-state electric companies. This Court noted that the effect of these credits and other exemptions in the statute meant that "Louisiana consumers of OCS gas for the most part are not burdened by the Tax, but it does uniformly apply to gas moving out of the State." *Id.*

This Court struck down the Louisiana tax and specifically found that Louisiana's practice of providing in-state operators with credits for "first use" taxes paid against other state-imposed taxes violated the Commerce Clause. *Id.* at 759. The Court held that because these entities "may recoup any increase in the cost of gas attributable to the First-Use Tax through credits against various taxes or a combination of taxes *otherwise owed to the State of Louisiana,* Louisiana consumers of OCS gas are thus substantially protected against the impact of the First-Use Tax." *Id.* at 757 (emphasis added) (citation omitted). As a result, this Court struck down Louisiana's "first use" tax scheme, noting that the Commerce Clause mandates "equality of treatment between local and interstate commerce" and that "the pattern of credits and exemptions allowed under the Louisiana statute undeniably violates this principle of equality." *Id.* at 759.

As this Court recognized in *Maryland* v. *Louisiana*, tax schemes like those enacted by Louisiana and Kentucky that tax an industry evenly but provide exemptions, credits or subsidies that abate the burden of the industry-wide tax on in-state interests violate the Commerce Clause because the "practical operation" of these schemes "'work discrimination against interstate commerce'" just like a traditional tariff. 451 U.S. at 756, quoting *Best & Co.* v. *Maxwell*, 311 U.S. 454, 456 (1940). Allowing states to enact such schemes, as the Sixth Circuit has done in this case, jeopardizes interstate commerce by providing states with an easily-used contrivance for circumventing the limitations of the Commerce Clause.

This Court has previously recognized that it is useful to consider how a tax scheme could be used to circumvent limitations recognized in the Court's prior Commerce Clause cases. For example, in *Camps Newfound/Owatonna, Inc.* v. *Town of Harrison, Maine*, 520 U.S. 564, 594-95 (1997), this Court compared a Maine tax scheme to a Hawaii tax scheme that had been struck down earlier in *Bacchus Imports LTD* v. *Dias*, 468 U.S. 263 (1984), and struck down the Maine tax scheme because it allowed states to easily circumvent the Commerce Clause protections discussed in *Bacchus*. Likewise in this case, comparing the Kentucky tax scheme to three similarly discriminatory tax schemes that this Court has previously struck down demonstrates how easily states could mimic the Kentucky tax scheme to discriminate against interstate commerce in any industry, thereby rendering the Commerce Clause a dead letter.

In *Armco, Inc.* v. *Hardesty*, 467 U.S. 638 (1984), this Court, in an eight-to-one decision, struck down a

West Virginia tax that required every entity engaged in the business of selling tangible property at wholesale to pay a percentage of its gross receipts to the State, but exempted in-state manufacturers from paying the tax. West Virginia argued that the tax did not discriminate against interstate commerce because in-state manufacturers were subject to a larger tax. *Armco, Inc.*, 467 U.S. at 641. This Court disagreed, held that "West Virginia's tax does discriminate unconstitutionally against interstate commerce," *id.*, and explained that:

> "[t]he tax provides that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it. Thus, if the property was manufactured in the State, no tax on the sale is imposed. If the property was manufactured out of the State and imported for sale, a tax of 0.27% is imposed on the sale price." *Id.* at 642.

Under the Sixth Circuit's reasoning in the instant case, West Virginia could have brought about this same discriminatory result merely by creating a fund from the proceeds of the tax on the sale of property at wholesale and using that fund to pay off burdens on behalf of in-state manufactures, such as the manufacturers' local property taxes or even a portion of the state-imposed manufacturing tax. The discriminatory effect would have been the same — only sellers who do not manufacture their goods in West Virginia would face an increased overall burden on the goods they sell in the state — but the scheme would not have run afoul of the Commerce Clause under the Sixth Circuit's analysis.

In *New Energy Co.* v. *Limbach*, 486 U.S. 269, 278 (1988), this Court struck down an Ohio tax scheme that encouraged in-state production of ethanol. Under the Ohio scheme, gasoline dealers were given a credit against the state sales tax on gasoline if they mixed their gasoline with ethanol, but only if the ethanol was produced in Ohio or another state that grants a similar credit for using Ohio-produced ethanol. *Id.* at 269. This Court, in a unanimous decision, held that the statute impermissibly discriminates against interstate commerce because it "explicitly deprives certain products of generally available beneficial tax treatment because they are made in certain other States" and "imposes an economic disadvantage upon out-of-state sellers." *Id.* at 274, 275.

Under the Sixth Circuit's rationale, Ohio could have achieved the same discriminatory result without violating the Commerce Clause. For example, Ohio could have imposed a tax on all ethanol sold in the state, created a fund from the proceeds of that tax, and used those proceeds to pay off financial burdens borne by in-state ethanol producers. Specifically, Ohio could have used the proceeds of such a fund to pay the local property taxes of any property used to produce grain for ethanol production, to pay for grain itself and give that grain to in-state ethanol producers, or even to pay a state-imposed tax owed only by in-state producers such as Ohio Rev. Code Ann. § 5737.03 (West 2008), which taxes the handling of all grain, including grain used to make ethanol. Using such a scheme, the state of Ohio could have discriminated in favor of in-state ethanol producers, while at the same time complying with the Sixth Circuit's interpretation of the Commerce Clause.

Finally, in *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 265 (1984), this Court invalidated a Hawaii tax scheme that encouraged consumption of two kinds of locally produced alcoholic beverages by exempting those beverages from the twenty percent (20%) excise tax Hawaii levied on sales of alcoholic beverages. The locally produced alcoholic beverages that Hawaii attempted to exempt were okolehao — "a brandy distilled from the root of the ti plant, an indigenous shrub of Hawaii" — and a locally produced wine made from pineapples. *Id.* This Court had no difficulty in striking down Hawaii's tax scheme as unconstitutional, holding that the exemption for okolehao and pineapple wine "violated the Commerce Clause because it had both the purpose and effect of discriminating in favor of local products." *Id.* at 273. This Court further explained that "[a] cardinal rule of Commerce Clause jurisprudence is that '[n]o State, consistent with the Commerce Clause, may impose a tax which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business.'" *Id.* at 268, quoting *Boston Stock Exch.* v. *State Tax Comm'n*, 429 U.S. 318, 329 (1977) (internal quotation marks omitted).

Hawaii, like West Virginia and Ohio in the examples above, would have been empowered to bring about the same discriminatory effect under the Sixth Circuit's interpretation of the Commerce Clause by mimicking Kentucky's discriminatory tax scheme. Instead of a direct exemption for okolehao and pineapple wine from Hawaii's excise tax, Hawaii could have taxed all alcoholic beverages equally and then placed a portion of the proceeds into a State fund for the purpose of paying costs and fees on behalf of manufacturers of okolehao and pineapple wine. For example, Hawaii could have paid the local

real property taxes for any property in Hawaii used to produce okolehao, subsidized the purchase of ti root and pineapple when used in the production of okolehao and pineapple wine, or even used the proceeds to pay off the state-imposed manufacturing tax, Haw. Rev. Stat. Ann. § 237-13 (LexisNexis 2007). The net effect to such a scheme would have been the same — granting local manufacturers of these alcoholic beverages a competitive advantage over out-of-state rivals in the market for alcoholic beverages.

These hypothetical applications of the basic mechanics of the Kentucky tax scheme to tax schemes previously invalidated by this Court demonstrate that the Sixth Circuit's decision below is both erroneous and dangerous. Allowing states to offset the effect of an industry-wide tax on in-state interests by eliminating other burdens borne only by in-state operators is no less discriminatory in effect than exempting in-state operators from the industry-wide tax itself.

In fact, this case presents an even clearer example of discrimination. Unlike the Louisiana scheme in *Maryland* v. *Louisiana* that less obviously abated the effect of the industry-wide tax by simply providing credits against other state-imposed taxes, the Kentucky scheme is blatant in its discrimination. The Kentucky scheme creates a separate fund from the proceeds of the industry-wide tax for the sole purpose of paying off burdens borne only by in-state operators — franchise fees. This is a far more direct, and indeed more troubling, form of discrimination than the offsetting tax credits at issue in *Maryland* v. *Louisiana*. It simply is too easy for states to mimic the Kentucky scheme and discriminate in favor of in-state operators if the Sixth Circuit's analysis is

allowed to stand. Under such a scheme, the ability of a state to discriminate is virtually limitless. This Court has consistently taken the position that the protections afforded to interstate commerce by the Commerce Clause are far more robust. As a result, this Court should grant the Satellite Operators' petition for a writ of certiorari and make clear that states cannot so easily circumvent the protections of the Commerce Clause.

II. THE KENTUCKY TAX SCHEME SUBVERTS THE LEGISLATIVE PROCESS IN THE SAME MANNER AS THE MASSACHUSETTS STATUTE AT ISSUE IN *WEST LYNN CREAMERY* v. *HEALY*.

The Kentucky tax on multichannel video programming bears two hallmarks that identify it as belonging to the category of taxes that this Court has repeatedly struck down as discriminating against interstate commerce. It provides benefits to in-state interests by burdening, exclusively, out-of-state interests. It also mollifies in-state interests that ordinarily would be expected to oppose the tax scheme, thereby circumventing the balancing of interests inherent within the legislative process that is ordinarily relied upon to provide taxpayers with a degree of protection against abusive tax schemes. As the NTU has observed in numerous cases, including cases involving taxes on rental-care services and passenger facility charges on airline tickets, imposing taxes that disproportionately burden citizens who have no vote in the jurisdiction is attractive because of the political benefit it provides. See, *e.g.*, Brian Riley, *The Less You See, The More You Pay: The Burden of Hidden Taxes*, NTUF Policy Paper 104, August 11, 1998.

This Court has long recognized that a purpose of the Commerce Clause's prohibition of state laws discriminating against interstate commerce is to prevent states from succumbing to the temptation to provide benefits to those within the state at the expense of out-of-state interests. For example, in *South Carolina State Highway Dep't* v. *Barnwell Bros.*, this Court noted that its dormant analysis of the Commerce Clause arose from "the thought, often expressed in judicial opinion, that when the regulation is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation where it affects adversely some interests within the state." 303 U.S. 177, 185 n.2 (1938).

This "thought" has been prominent in this Court's more recent Commerce Clause jurisprudence. For example, in *Minnesota* v. *Clover Leaf Creamery Co.*, this Court upheld a Minnesota law banning retail sale of milk in plastic nonreturnable, nonrefillable containers on the ground that it burdened in-state and out-of-state dairies alike, stating that "[t]he existence of major in-state interests adversely affected by the Act is a powerful safeguard against legislative abuse." 449 U.S. 456, 473 n.17 (1981). Likewise, in *Kassel* v. *Consol. Freightways Corp. of Delaware*, this Court refused to accord an Iowa law barring use of trucks longer than 60 feet on Iowa's interstate highways the usual "'special deference' to state highway safety regulations," noting that "[t]his traditional deference 'derives in part from the assumption that where such regulations do not discriminate on their face against interstate commerce, their burden usually falls on local economic interests as well as other States' economic interests, thus ensuring that a

State's own political process will serve as a check against unduly burdensome regulations.'" 450 U.S. 662, 675 (1981), quoting *Raymond Motor Transp., Inc.* v. *Rice*, 434 U.S. 429, 444 n.18 (1978). The Court held that "[l]ess deference to the legislative judgment is due, however, where the local regulation bears disproportionately on out-of-state residents and businesses" and struck down the Iowa law because "Iowa's scheme, although generally banning large doubles from the State, nevertheless has several exemptions that secure to Iowans many of the benefits of large trucks while shunting to neighboring States many of the costs associated with their use." *Id.*

This concern was also a key component of the Court's decision in *West Lynn Creamery*, in which Justice Stevens noted that the Massachusetts tax-and-subsidy scheme was constitutionally problematic because, among other reasons, it provided a subsidy to "one of the most powerful" groups "which would otherwise [be expected to] lobby against the" tax scheme:

> "when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy. So, in this case, one would ordinarily have expected at least three groups to lobby against the order premium, which, as a tax, raises the price (and hence lowers demand) for milk: dairy farmers, milk dealers, and consumers. But because the tax was coupled with a subsidy, one of the most powerful of these

> groups, Massachusetts dairy farmers, instead of exerting their influence against the tax, were in fact its primary supporters." 512 U.S. at 200-201.

The Kentucky tax scheme subverts the legislative process, and reaps the same kind of ill-gotten gains, as the statutes at issue in *West Lynn Creamery* and *Kassel*. Kentucky mollified the two powerful in-state interests that ordinarily would have been expected to lobby against its new tax on multichannel video programming. Under Kentucky's tax scheme, in-state cable operators were subjected to a new state-level tax on their video programming for the first time, and localities lost their right to impose franchise fees on cable operators, but both of these in-state interests were "mollified" by the State. Kentucky mollified the in-state cable operators by eliminating the obligation to pay franchise fees imposed by Kentucky's subordinate localities, and it mollified the localities by providing them with the proceeds of the tax on multichannel video programming, thereby ensuring that the localities do not lose revenue. The only party made worse off by Kentucky's tax scheme (besides the state's consumers, who are deprived of the benefits of fair competition) are the in-state cable operators' only marketplace rivals — the out-of-state Satellite Operators — who pay for the benefits provided to the cable operators and localities under Kentucky's tax scheme by paying the full tax with no abatement, whatsoever.

As a result, the Kentucky tax scheme discriminates against interstate commerce just like a traditional tariff. The result is that in-state cable operators can reduce price and gain market share from their out-of-state rivals, the Satellite Operators. This is pre-

cisely the kind of scheme the Commerce Clause was designed to prevent.

In the end, this case is worthy of this Court's consideration for a simple reason. The Sixth Circuit's decision is a serious threat to the continued vitality of the Commerce Clause's protection of interstate commerce from discriminatory taxes. The Kentucky tax on multichannel video programming, blessed below by the Sixth Circuit, is a thinly veiled tariff. As NTU has demonstrated, similar schemes can be implemented by any other state and can be used to discriminate in favor of in-state interests in practically any industry. This Court, in its prior cases, has given the Commerce Clause a robust meaning that cannot countenance the type of discrimination inherent within the Kentucky scheme. Accordingly, this Court should grant the Satellite Operators' petition for a writ of certiorari and make clear that the Kentucky scheme cannot serve as a model for constitutionally permissible discrimination against interstate commerce.

CONCLUSION

For these reasons, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX

APPENDIX

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February 15, 2008

VIA E-MAIL AND U.S. MAIL

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RE: *DIRECTV, Inc. and EchoStar Satellite L.L.C. v. Treesh*, No. 07-1004 (S. Ct.)

Dear Mr. Rosenkranz,

I am writing to you on behalf of the National Taxpayers Union ("NTU") to confirm our conversation in which I requested the consent of petitioners DIRECTV, Inc. and EchoStar Satellite L.L.C. (collectively, "the petitioners") to NTU filing an *amicus curiae* brief in support of the petition for a writ of certiorari filed in the above-styled action. I appreciate your having provided me with the petitioners' consent and am following up, pursuant to Supreme Court Rule 37(2)(a), to obtain that consent in writing.

Please indicate your consent by signing below and return the signed letter to me by fax at 202-408-6399. Thank you for your assistance. If you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

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VIA E-MAIL AND U.S. MAIL

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RE: *DIRECTV, Inc. and EchoStar Satellite L.L.C. v. Treesh*, No. 07-1004 (S. Ct.)

Dear Mr. Dowell,

I am writing to you on behalf of the National Taxpayers Union ("NTU") to confirm our conversation from yesterday afternoon in which I requested the consent of respondent Mark Treesh, Commissioner for the Department of Revenue of the Commonwealth of Kentucky, to NTU filing an *amicus curiae* brief in support of the petition for a writ of certiorari filed in the above-styled action. I appreciate your having provided me with Commissioner Treesh's consent and am following up, pursuant to Supreme Court Rule 37(2)(a), to obtain that consent in writing.

Please indicate your consent by signing below and return the signed letter to me by fax at 202-408-6399. Thank you for your assistance. If you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

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No. 07-1004

IN THE
Supreme Court of the United States

DIRECTV, INC. AND ECHOSTAR SATELLITE L.L.C.,

Petitioners,

v.

MARK TREESH, Commissioner for the Department of Revenue for the Commonwealth of Kentucky,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF OF *AMICI CURIAE* PUBLIC KNOWLEDGE, CONSUMER FEDERATION OF AMERICA IN SUPPORT OF THE PETITION

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INTEREST OF THE *AMICI*

Public Knowledge and Consumer Federation of Amerca respectfully submit this brief in support of the petition for writ of certiorari to the United States Court of Appeals for the Sixth Circuit.[1]

Public Knowledge is a Washington, D.C. based not-for-profit public interest advocacy and research organization. It is dedicated to protecting consumers' rights and the core democratic principles of openness, public access, and the capacity to innovate and compete in the digital age. Public Knowledge seeks to guard these cultural values at all layers of our communications systems through legislative, administrative, legal, and grass-roots efforts.

Consumer Federation of America is an advocacy, research, education, and service organization which works to advance pro-consumer policy on a variety of issues before Congress, the White House, federal and state regulatory agencies, state legislatures, and the

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[1] No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the *amici curiae*, or their counsel, made a monetary contribution to its preparation or submission. The parties have consented to the filing of this brief and each has been given at least 10 days notice of *amici*'s intention to file. Letters of consent have been filed with the Office of the Clerk of this Court.

courts. In addition to its policy efforts, Consumer Federation of America conducts research, educates the public and policymakers, and supports other like-minded organizations on consumer issues.

The decision below has broad implications for consumer choice and costs as well as for the diversity of voices in the video and Internet services which are piped daily into 95 million American homes. The Sixth Circuit has provided a recipe for state legislatures to circumvent this court's ruling in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), and to favor in-state interests at the expense of interstate commerce. If schemes such as this, designed to create an anticompetitive market, are permitted to continue in the face of contrary constitutional law, the cost of favoring in-state interests will be paid for by consumers, speakers, and innovators. *Amici curiae* uniquely represent the interests of consumers and Internet users in a proceeding which is otherwise about the interest of states versus the interest of certain video providers.

None of *amici curiae* is affiliated with any cable company, Direct Broadcast Satellite ("DBS") provider, other Multichannel Video Programming Distributor ("MVPD"), or party to this action.[2]

---

[2] *Amici* would also like to acknowledge the assistance of Michael Weinberg, George Washington University Law School, in the preparation of this brief.

SUMMARY OF ARGUMENT

Tax schemes such as the one at issue in this case raise issues of national importance because they harm the competition which is critical to ensuring that MVPD consumers receive the best service and have access to the greatest diversity of voices at the lowest price.

States have demonstrated time and time again that they have incentives to find ways to evade the Dormant Commerce Clause to financially burden out-of-state commerce in order to favor in-state economic interests. The MVPD market is simply one more market where one incumbent industry–cable–has a significant in-state footprint, generating local jobs and revenues, while a new competitor–DBS–has almost no in-state presence at all. Kentucky's tax-and-pay setup is an attempt to dodge precedent and engage in prohibited discriminatory taxation in this market.

Competition in the MPVD market benefits consumers in three broad ways. First, competition in the MVPD market translates to diversity of voices heard by the vast majority of American households who subscribe to multichannel services, and for the growing number who choose to express themselves through Internet services provided by those same companies. Second, competition disciplines prices across providers, lowering costs for all subscribers to MVPD services and increasing the availability of services nationwide. Third, competition increases quality of service to

multichannel customers. DBS-based competition in particular has a demonstrated track record of encouraging innovation in the market, providing consumers with advanced services including better picture quality, music offerings, and Internet and telephone services. Finally, these benefits are felt even more strongly by rural customers, who may have no locally-based MVPD option at all.

Congress and the FCC have repeatedly demonstrated their commitment to achieving consumer benefits through competition in the MVPD market. By leveling the playing field, Congress has sought to stop runaway cable pricing and encourage innovation. To a large extent, it has succeeded. But to the extent that MVPD prices still outpace inflation, the problem can be partially attributed to the discriminatory treatment of cable's primary competitor in a market where consumers, when faced with higher prices, are very likely to switch providers or leave the market.

Finally, the national issues raised by the Sixth Circuit's decision apply not only to the current MVPD competitors, but to future entrants and to completely unrelated markets as well. Creating an anticompetitive market by favoring businesses with an in-state footprint will harm consumers by restricting competition and innovation in video services, Internet services, and new services which have not yet been imagined. We ask that this court grant the petition for certiorari in order to determine that

states cannot engage in discriminatory taxation, no matter what regulatory structure they use to disguise the discriminatory purpose.

ARGUMENT

I. A DETERMINATION OF THE UNCONSTITUTIONALITY OF DISCRIMINATORY TAXES IS CRITICAL TO MVPD CONSUMERS BECAUSE SCHEMES SUCH AS KENTUCKY'S HARM COMPETITION

> *In general, if any branch of trade, or any division of labour, be advantageous to the public, the freer and more general the competition, it will always be more.*

Adam Smith, *The Wealth of Nations*, Book II, Chapter II (1776). It is now axiomatic that competition is beneficial to consumers, both because it increases choice and because it lowers prices. For a more modern, in-depth explanation of the consumer benefits of competition, see F. M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin Co. 1990).

As Congress has recognized, the pro-speech and pro-consumer effects of competition apply in the MVPD world as well: "There is a substantial governmental and First Amendment interest in promoting a diversity of views provided through multiple technology media," and "[w]ithout the presence of another multichannel video programming distributor, a cable system faces no local competition. The result is undue market

power for the cable operator as compared to that of consumers and video programmers." Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, §§ 2(a)(2), 2(a)(6), 106 Stat. 1460, 1460 (1992) (codified at 47 U.S.C. § 521 note) [hereinafter *1992 Cable Act*].

A. States Have Incentives to Disadvantage Cable's Primary Competitor in the MVPD Market

DBS is the single largest competitor to cable, representing 29% of MVPD subscribers as of June 2006; all other non-cable competitors combined make up only 2.6% of the market. Federal Communications Commission, *FCC Adopts 13th Annual Report to Congress on Video Competition and Notice of Inquiry for the 14th Annual Report* at 3 (Nov. 2007) [hereinafter *13th Annual Report Release*], *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-278454A1.pdf.[3] According to one report, if DBS were removed from the market entirely, cable prices would be 15% higher and quality would fall, hurting consumers on two fronts. Austan Goolsbee & Amil Petrin, *The Consumer Gains from Direct Broadcast Satellites and the Competition With Cable TV*, 72 Econometrica 351, 373 (2004).

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[3] As of the filing of this brief, the full text of the 13th Annual Report was not yet public, so only the factual findings reported in the public announcement are cited.

As described in petitioners' brief, states derive significant benefits from cable's in-state activities, while DBS providers have little or no in-state presence. This provides states with the incentive to flout the nationwide competition which would benefit consumers. And while the damage to consumers is hidden in costs to out-of-state operators, lack of long-term innovation, and slow price increases, the in-state benefit to cable companies and the state itself through employment, construction, and franchise fees is easy to see.

This anti-competitive incentive is what the Dormant Commerce Clause is supposed to prevent: schemes "designed to benefit in-state economic interests by burdening out-of-state competitors." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192 (1994) (citing *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273-274 (1988)).

B. Competition in the MVPD Market Benefits Consumers

The general benefits of competition are realized by consumers in the MVPD market in three ways: First, competition encourages MVPDs to diversify their offerings, resulting in a broader diversity of speech being available to consumers. Second, it encourages innovation, creating new services and improving quality for viewers. Finally, competition reins in prices for all MVPD subscribers. To the extent that tax schemes such as the one at issue hurt competition, they also hurt consumers in all

three areas.

1. Competition in the MVPD Market Promotes a Diversity of Voices Critical to a Democratic Society.

As Congress has recognized, there is a "substantial . . . First Amendment interest in promoting a diversity of views provided through multiple technology media." *1992 Cable Act* § 2(a)(6). This court has also recognized this interest: "[A]ssuring that the public has access to a multiplicity of information sources is a governmental purpose of the highest order, for it promotes values central to the First Amendment." *Turner Broad. Sys. v. F.C.C.*, 512 U.S. 622 (1994). The FCC, too, has echoed this court's observation that "[i]t has long been a basic tenet of national communications policy that 'the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public.'" *In re Comcast Corp.*, 17 F.C.C.R. 23246, ¶ 27 (2002) (quoting *Turner Broad. Sys. v. F.C.C.*, 512 U.S. 622, 663 (1994)).

As of June 2006, there were approximately 95.8 million households in the United States which subscribed to an MVPD service. *13th Annual Report Release* at 3. According to the 2000 census, there are roughly 105 million households in the United States. *See USA Quickfacts*, United States Census Bureau, *available at* http://quickfacts.census.gov/qfd/states/00000.html. And for the over 90% of households which

subscribed to an MVPD service in 2004 and 2005, the average one tuned into television for over eight hours per day. *In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video, 12th Annual Report* at 3, F.C.C. 06-11 (Feb. 2006) [hereinafter *12th Annual Report*].

In America today, the delivery of video services to homes is much more than an entertainment business. It is a primary speech outlet–one through which American households view over 275 billion hours of television-based speech per year. DBS has already made progress in promoting consumer choice and diversifying voices on this communications channel. In 2006, the FCC's annual report on competition in the MVPD market stated that "[c]ompetition in the delivery of video programming services has provided consumers with increased choice, ... In particular, the effect of DBS competition has resulted in the addition of networks to cable operators' channel line ups, . . ." *12th Annual Report* at 4. Further, DBS's nationwide structure allows it to provide a wider variety of options than local cable franchises. For instance, while foreign-language programming may not be economically viable in a given cable market, DBS can aggregate the demand for it nationwide and offer it to consumers in every market across the United States.

Video services are also no longer one-way channels for funneling information to consumers;

both cable and DBS providers (typically through joint ventures) offer Internet access, through which millions of Americans are expressing themselves to a global audience. As of 2003, 53 million American adults had posted their own text, pictures, or video on the Internet for all to see. *See* Pew Internet and American Life Project, *Content Creation Online* (Feb. 29, 2004), *available at* http://www.pewInternet.org/pdfs/PIP_Content_Creation_Report.pdf. Any damage to the competitiveness of DBS-based MVPD services will also be felt by those who subscribe to related Internet services.

Reducing competition to promote in-state commercial interests does not just raise prices for consumers, but reduces the diversity of voices and speech venues available to all Americans.

2. Competition in the MVPD Market Provides Economic Benefits to Consumers

MVPD competition from DBS has already had the effect of lowering prices for subscribers across all multichannel providers. One study concluded that without DBS's entry into the market, cable prices would be 15% higher. Austan Goolsbee & Amil Petrin, *The Consumer Gains from Direct Broadcast Satellites and the Competition With Cable TV*, 72 Econometrica 351, 373 (2004).

But current levels of competition have not been enough to completely discipline pricing.

This past year, the FCC reported that despite technological improvements in video delivery, prices in the MVPD market continue to outpace the general level of inflation. *13th Annual Report Release* at 1. Notably, "DBS competition has not checked cable prices to the same extent as competition from wireline providers"– providers who, like cable, have a significant in-state presence. *Id.* at 1; *See also* U.S. Government Accountability Office, *Direct Broadcast Satellite Subscribership Has Grown Rapidly, but Varies Across Different Types of Markets* at 33, No. GAO-05-257 (Apr. 2005) [hereinafter *GAO Report*], *available at* http://gao.gov/ (reporting that cable prices were 16% lower in markets with a second cable competitor).

In the same way that competition lowers prices for consumers, reduced competition raises them. If it is allowed to proceed unchecked, discriminatory taxing will raise prices not just for DBS users, but for all MVPD subscribers. Especially given the price sensitivity of MVPD customers, which is discussed below, differential treatment of DBS and cable services in a number of states could account for DBS's failure to fully control cable price increases despite its positive effect on other areas, including network availability, picture quality, and overall innovation.

3. Competition in the MVPD Market Provides Service Improvements to Consumers

In addition to delivering more diverse voices and lowering prices, the FCC noted that MVPD competition provided consumers with "better picture quality[] and greater technological innovation." *12th Annual Report* at 4. The summary of the 2006 report indicates that consumers continue to receive these benefits. *See 13th Annual Report Release* at 1. Specifically, cable operators have made investments which enable "more channels of basic and digital cable services, premium movie services, pay-per-view service, high-definition service, high-speed Internet access services, CD-quality music, cable telephony, and more personalized programming options." *12th Annual Report* at 22.

The FCC attributes these new services in large part to competition from DBS; and in response to cable's new services, DBS providers have expanded their own offerings: "Cable operators have responded to the growth of DBS and its competitive service offerings by, among other things, expanding their channel line ups and bundling video service with other service offerings, such as cable modem service or telephone service. . . . These competitive efforts are matched by DBS operators' offering of local broadcast channels, additional sports and international programming, and advanced set-top boxes with digital video recorder (DVR)

capabilities." *12th Annual Report* at 4.

The Government Accountability Office ("GAO") also reports that DBS penetration is 20% higher in places where cable is not offering these advanced services, suggesting that DBS is performing well both at spurring innovation on the cable side and providing a viable consumer alternative to cable services. *See GAO Report* at 9. Taxes which disproportionately burden DBS for the benefit of cable will slow these innovations, as they will be less necessary for cable to compete in the marketplace.

4. Rural Consumers Gain Additional Benefit from DBS Availability

In addition to broadly competing with cable, DBS has a much higher adoption rate in rural areas. *GAO Report* at 2. In areas where no cable service is available at all (which are often rural), DBS adoption rates are 53% higher. *Id.* at 2. This means that in such regions–where DBS is always available–discriminatory tax schemes will directly translate to an increase in consumer costs, driving a significant fraction of consumers out of the market altogether and producing higher prices for the rest. Further, any harm to DBS in markets which have cable as well is visited more powerfully on rural customers, who do not have the benefit of a state-preferred option available.

C. Congress Has Turned to Competition to Protect Consumers in the MVPD Market

Both Congress and the FCC have recognized the value of competition to consumers in the MVPD market and the dangers of anti-competitive behavior by local incumbents. This recognition and the accompanying steps taken to promote competition demonstrate the importance of a level playing field both to consumers and to the health of interstate commerce.

As early as 1984, Congress recognized the potential for cable to corner the MVPD market and reduce the diversity of voices heard by consumers. To combat this possibility, it enacted the "70/70 rule," which states that "at such time as cable systems with 36 or more activated channels are available to 70 percent of households within the United States and are subscribed to by 70 percent of the households to which such systems are available, the Commission may promulgate any additional rules necessary to provide diversity of information sources." An Act to Amend the Communications Act of 1934 to Provide a National Policy Regarding Cable Television § 612, 47 U.S.C. § 532(g) (1984). Last year, the FCC announced that cable had likely met this threshold; because not all sources agreed, the Commission then ordered cable companies to provide their own data to confirm or deny that the threshold had been met. *13th Annual Report*

Release at 1, 3. Whether or not the 70/70 threshold has technically been met, cable market share has grown to the point that it threatens the diversity which Congress intended to create.

In 1992, Congress passed–as the only veto override in the presidency of George H. W. Bush–the *1992 Cable Act*, which was a sweeping attempt to curb cable's monopoly power by encouraging competition with other MPVDs. At the time, cable had no competition at all:

> [T]he cable industry is a monopoly. That is why we are here today. It has absolutely no competition across this country. As a result, . . . consumers are left to the mercy of the cable industry, which has resulted in a three times the rate of inflation increase in their rates every year for the last 8 years in a row.

138 Cong. Rec. H8671, H8671 (daily ed. Sept. 17, 1992) (statement of Rep. Markey). In considering the Act, the Senate Commerce, Transportation, and Science committee noted that "[t]his evidence [of historical and projected rate increases] provides the Committee with significant and legitimate reasons to be greatly concerned that subscribers, in a deregulated marketplace, are at the mercy of cable operators' market power." *Senate Report (Commerce, Science, and Transportation Committee) on Cable Television Consumer Protection and Competition Act of 1992*, S. Rep. No. 102-92 at 8 (1992), *reprinted in* 1992 U.S.C.C.A.N. 1133, 1140.

Congress sought to remedy this monopoly power through competition: "Competition, not Government intervention, is the best long-term regulator of this marketplace. Competition gives the best service and the best price." 138 Cong. Rec. S14583, S14583 (daily ed. Sept. 22, 1992) (statement of Sen. Lieberman). As Senator Lieberman recognized, consumers benefit most when states do not engage in impermissible protectionism to the detriment of interstate commerce and when competition is allowed to flourish.

To combat cable's monopoly power and promote genuine MVPD competition, the *1992 Cable Act* commanded the FCC to promulgate regulations which would prohibit this type of discrimination "in order to promote the public interest, convenience, and necessity by increasing competition and diversity in the multichannel video programming market and the continuing development of communications technologies." *See 1992 Cable Act* § 628, 47 U.S.C. §§ 548(c)(2), 548(c)(1). In fact, section 628 of the *1992 Cable Act* is titled "Development of competition and diversity in video programming distribution," *see 1992 Cable Act* § 628, 47 U.S.C. § 548, and its stated purpose is

> to promote the public interest, convenience, and necessity by increasing competition and diversity in the multichannel video programming market, to increase the availability of satellite cable programming and satellite

> broadcast programming to persons in rural and other areas not currently able to receive such programming, and to spur the development of communications technologies.

1992 Cable Act § 628, 47 U.S.C. § 548(a).

One of the anti-competitive forces which the *1992 Cable Act* sought to limit was the vertical integration of the cable market. Cable MVPDs also owned numerous channels, and would only offer them to MVPD competitors at usurious prices, if at all. The preamble to the Act described the situation thus:

> The cable industry has become vertically integrated; cable operators and cable programmers often have common ownership. As a result, cable operators have the incentive and ability to favor their affiliated programmers. This could make it more difficult for noncable-affiliated programmers to secure carriage on cable systems.

1992 Cable Act § 2(a)(5). To combat this, Congressed imposed "program access" rules, which enabled competition by forcing cable companies to provide cable-owned channels to competitors at reasonable rates. *See 1992 Cable Act* § 628, 47 U.S.C. § 548. Without these program access rules, MVPD competitors like DBS would not have been able to compete, and

cable would likely still be a monopoly.[4]

Congress has since passed other legislation intended promote competition between DBS and cable: The Satellite Home Viewer Improvement Act of 1999 sought to achieve a similar purpose as the *1992 Cable Act* by ensuring equal access by competitors to local programming. According to the FCC, its goal is "to place satellite carriers on an equal footing with local cable television operators when it comes to the availability of broadcast programming, and thus gives consumers more and better choices in selecting a multichannel video program distributor (MVPD), such as cable or satellite service." Federal Communications Commission, *Satellite Home Viewer Protection Act Page*, *at* http://www.fcc.gov/mb/shva/; *s ee also* Satellite Home Viewer Improvement Act of 1999, S. 1948, 106th Cong. (1999).

When taken together, these laws explicitly

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[4] Through the *1992 Cable Act*, Congress also sought to promote competition in numerous other ways. It imposed explicit ownership restrictions to limit vertical and horizontal integration in the MVPD market. *See 1992 Cable Act* § 613, 47 U.S.C. § 533. Through "leased access" rules, it ensured that cable companies would provide channel capacity to competitors' channels, which they might otherwise choose not to deliver to consumers. *See 1992 Cable Act* § 612, 47 U.S.C. § 532. And by regulating rates in the MVPD market, it helped to mitigate the anticompetitive effects of cable's monopoly power. *See 1992 Cable Act* § 623, 47 U.S.C. § 543.

demonstrate Congress' belief in the importance providing a level playing field for MVPDs, and their preference to regulate only to the extent necessary to ensure fair competition between multichannel distributors. The problem is not solved; cable now controls roughly 70% of the market, *See 13th Annual Report Release* at 3, and while it is no longer a monopoly, the threat of unchecked market power, bolstered by discriminatory taxation, still looms large. And in areas such as discriminatory taxation, which exacerbate the problem and which are governed constitutionally, no such regulations should be necessary.

Protectionism through discriminatory taxation is constitutionally prohibited and contrary to federal policy. Congress' stress on the importance of competition in the MVPD market merely underlines the importance of a clear Supreme Court ruling that states may not evade the Dormant Commerce Clause through schemes such as the one at issue here.

D. Price Matters Because MVPD Consumers are Price-Sensitive

Consumers in the MVPD market are price-sensitive, meaning that small increases in the price of one provider will produce comparatively large shifts of consumers away from that provider, often to competitors. As a result, differential taxation will directly impact competition and harm all of the goals discussed above.

In summarizing eight studies of price elasticity in the MVPD market, two Brookings Institution fellows reported that "[t]he studies . . . all conclude that the own-price elasticity of demand for basic cable television service is price elastic. That is, a one percent decrease in cable price will induce more than a one percent increase in subscribers." Robert W. Crandall & Robert Litan, *The Benefits of New Wireline Video Competition for Consumers and Local Government Finances* at 7 (2006), *available at* http://www.criterioneconomics.com/docs/TELCO_MVPD_Entry_Cable_Franchise_FINAL.pdf. Individually, the studies showed that such a 1% price change would change demand between 1.5% and 5.9%. *Id.* at 7.

One of these studies further showed that "the cross-price elasticity of demand between expanded basic cable prices and DBS subscribership was 0.9. This result means that a one percent decrease in the price of expanded basic cable would induce a 0.9 percent decrease in DBS subscribership, which indicates that consumers treat these two services as close substitutes." *Id.* at 6 (citing Austan Goolsbee & Amil Petrin, *The Consumer Gains from Direct Broadcast Satellites and the Competition With Cable TV*, 72 Econometrica 351, 369 (2004)).

When taken together, these studies suggest that a five percent change in price or costs–such as that created by the Kentucky taxing scheme–is likely to produce a drastic effect on

competition. Assuming the high end of the range described by Crandall & Litan, such a switch could extend to as many as 26% of DBS subscribers, and in any event, would produce significant competitive harm, in turn increasing overall prices paid and reducing quality of service and the diversity of voices received by all American consumers.

II. THE SIXTH CIRCUIT'S DECISION RAISES AN ISSUE OF NATIONAL IMPORTANCE BECAUSE IT ALLOWS STATES TO SACRIFICE INNOVATION AND EFFICIENCY IN FAVOR OF PROTECTIONISM

A. State Protectionism Will Harm New Technologies in the MVPD Market

New competitors to cable are entering the marketplace; for instance, Verizon is currently rolling out television and Internet services over fiber optic cables. *See, e.g.*, *Verizon FiOS TV*, at http://www22.verizon.com/Content/FiOSTV/. Other emerging competitors are Internet-based: "The amount of web-based video provided over the Internet continues to increase significantly each year." *12th Annual Report* at 7; *13th Annual Report Release* at 4. Analysts suggest that the number of people worldwide who subscribe to Internet-based television services, or IPTV services, will grow to 13.5 million in 2007 and to as many as 72.6 million by 2011. *See IPTV Global Forecast – 2007 to 2011: Executive Overview*, MRG Media Research Group, Inc. (Oct. 2007), *available at*

http://www.mrgco.com/TOC_IPTV_GF1007.html.

IPTV services can be offered over almost any network, and so appear in many different forms. In some cases, such services are bundled with cable-based or DSL-based Internet services. In others, they are sold by third parties, and consumers receive their network services from existing services. Will states be allowed to determine which innovative services succeed based not on merit or consumer choice, but on tax structures which penalize those providers who do not use in-state franchise-based arrangements?

Future technologies can only be financed and rolled out if investors and innovators know that the market, and not in-state interests, will decide who succeeds. Unless this court determines that new technologies will be able to compete on equal footing with cable incumbents, they face uncertainty and the potential for discriminatory treatment, reducing investment and innovation in new MVPD services on a national scale.

B. Kentucky's Tax Schemes Will Inhibit Competition in Non-Video Markets As Well

When the *1992 Cable Act* was passed, who could have imagined the impact the Internet would have not just on video distribution, but on global communications and speech? The tax structure created in Kentucky could be applied to protect in-state interests not only in the

MVPD market, but in any market where a state can collect franchise fees or the equivalents for use of in-state resources and rights of way.

Internet services are but one example–albeit a closely parallel one–of how this can work. Some Internet services, such as cable-based or DSL-based providers, will have a strong in-state presence involving local investment and employment. Others, such as satellite-based Internet services, will have almost no in-state presence. *See 12th Annual Report* at 83. Emerging services, such as land-based wireless or mesh networks, may land somewhere in between. Competition between these different technologies and services needs to occur on a level playing field, where the benefits to consumers and the real cost of service determine which innovations succeed and fail. When states introduce additional costs based on their evaluation of each technology's in-state footprint, the benefits of our national unitary economy are not realized, and innovation is stifled.

The specter of state protectionism is encountered not only in the provision of Internet access, but in other traditionally in-state markets which now can be reached nationally or globally from any computer. Examples include Internet-based retail sales, which compete with in-state brick-and-mortar offerings, and Internet-based radio, which competes with local radio stations. And while there is currently a moratorium on state taxation of electronic commerce, that moratorium is only temporary,

and is currently set to expire in 2014. *See* Internet Tax Freedom Act Amendments Act of 2007, Pub. L. 110-108, 121 Stat. 1024 (2007) (codified at 47 U.S.C. § 151).

Will states be able to enact tax structures designed to burden the out-of-state interests to give the in-state offerings a competitive edge? In the same way that we cannot see now how the Internet marketplace will develop, we cannot predict what new markets will open up. If states are allowed to enact thinly disguised protectionism through tax-and-pay schemes such as the one here, entirely new technologies and innovations with national or global scope may fall prey to the self-interest of individual states. The question that this court should answer is whether states will be allowed to interfere with interstate commerce, introduce market inefficiencies, and stifle innovation in both old and new markets in order to protect in-state economic interests.

CONCLUSION

For these reasons, the Court should grant the petition for a writ of certiorari.

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